TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 192

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

ALUMINUM GOODS MANUFACTURING COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 1, 1932
CERTIORARI GRANTED OCTOBER 10, 1932

SUPREME COURT OF THE UNITED STATES

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1 Before U. S. Board of Tax Appeals

Docket No. 15814

ALUMINUM GOODS MANUFACTURING COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Appearances:

For Taxpayer: Paul Myers, Esq., Edwin S. Mack, Esq.

For Comm'r.: W. F. Gibbs, Esq., A. Lisenby, Esq., G. S. Herr, Esq., F. R. Shearer, Esq.

Docket Entries

1926

May 10—Petition received and filed.

" 14—Copy of petition served on solicitor.

" 14—Notification of receipt mailed taxpayer.

Jul. 13—Motion for 60 days extension to answer filed by solicitor.

" 19—Answer filed by solicitor.

" 19—Granted. Both sides notified.

Aug. 27—Copy of answer served on taxpayer. General Calendar.

1927

Apr. 22—Motion to withdraw answer and file amended answer filed by general counsel.

" 25—Copy of motion served on taxpayer. Assigned to June 7, 1927.

Jun. 7—Hearings had before Mr. Arundell on motion of April 22, 1927.

" 8—Ordered proceedings to be continued to Day Calendar of August 29, 1927 for hearing on motion.

Aug. 30—Hearing had before Mr. Green by agreement, continued three weeks, and answer to be amended.

Sep. 1—Ordered proceeding be continued to September 20, 1927, on respondent's motion April 22, 1927. Signed and filed. Both sides notified.

2 " 20—Hearing had before Mr. Littleton on respondent's motion April 4, 1927. Granted.

" 20—Ordered motion granted and respondent given 30 days to file amended answer. Signed and filed. Both sides notified.

1928

Dec. 3—Motion for transfer to Circuit Calendar, filed by taxpayer. Granted December 4, 1928.

1929

Apr. 17—Hearing set May 21, 1929 at Milwaukee, Wisconisn.

May 10—Motion for continuance subsequent to June 15, 1929, filed by taxpayer.
" 11—Order placing on Day Calendar of June 20, 1929, entered.
" 14—Motion for leave to amend answer, amendment tendered, filed by general counsel. May 16, 1929 granted.
Jun. 18—Motion to continue to some date subsequent to June 25, 1929, filed by taxpayer.
" 19—Motion granted and set for hearing June 27, 1929.
" 27—Hearing had before Mr. Arundell on respondent's motion to continue. Ordered to Reserve B.
" 27—Order proceeding be placed on Reserve Calendar for call on 20 days notice, entered.

1929

Nov. 14—Order placing on Circuit Calendar for Milwaukee, Wisconsin, entered.
" 19—Motion to place on Reserve Calendar filed by general counsel. No action necessary.

1930

May 21—Hearing set July 11, 1930 at Milwaukee, Wisconsin.
" 28—Order continuing to fall term 1930 on General Calendar.
Aug. 15—Hearing set October 6, 1930.
Oct. 6—Hearing had before Mr. Sternhagen on merits. Stipulation of facts filed. Petitioner's brief due in 30 days.
" 25—Transcript of hearing of October 6, 1930, filed.
3 Nov. 3—Motion for extension of 30 days from November 5, 1930 to file brief, filed by taxpayer.
" 4—Granted for both sides to December 5.
Dec. 17—Motion for extension to December 15, 1930 to file brief, filed by taxpayer. Granted to December 17, 1930.
" 17—Brief filed by taxpayer.

1931

Feb. 2—Opinion rendered, J. M. Sternhagen, Div. 10, for 1917–1919 & 1921. Judgment will be entered for respondent.
" 3—Motion for supplemental report, filed by general counsel.
" 4—Supplemental memorandum opinion rendered, J. M. Sternhagen, Div. 10.
" 6—Order of dismissal and judgment entered, Div. 10.
Jul. 31—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of error filed by taxpayer.
" 31—Proof of service filed.
Sep. 1—Agreed statement of evidence lodged.
" 1—Præcipe filed.
" 1—Proof of service of præcipe filed.
" 3—Agreed statement of evidence approved and ordered filed.

Before U. S. Board of Tax Appeals

Petition

Filed May 10, 1926

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:E:SM:60D CH, dated March 27, 1926, and as a basis of its proceeding alleges as follows:

1. Petitioner is a corporation organized and existing under and by virtue of the laws of the State of New Jersey, with its principal office at 15th and Franklin Streets, Manitowoc, Wisconsin.

4 2. Notice of deficiency, a copy of which is attached hereto and marked "Exhibit A," was mailed to the petitioner on March 27, 1926.

3. The tax in controversy is income and excess profits tax for the year ending December 31, 1917, and the amount thereof, as nearly as may be determined, is $29,250.11. The statement accompanying the notice of deficiency states a deficiency of $5,438.57. Waiver of the right to have taxes due for 1917 determined and assessed within five years after the return was filed, was filed on or about the 27th day of February, 1921, and claims for refund of income and excess profits tax paid for the year 1917 have been duly filed on the 5th day of February, 1923, and the 24th day of February, 1923, and an additional claim for refund was duly filed with the Commissioner of Internal Revenue in the month of March, 1923, and the amount for which claims for refund have been made includes the difference between $29,250.11 and the sum of $5,438.57 set forth in the statement accompanying the notice of deficiency.

The correction of this error in the taxes for 1917 amounting to $29,250.11 results in an increase based thereon of the invested capital of the petitioner for the years 1918, 1919, 1920 and 1921; and such change in invested capital reduces the deficiency in tax for the years 1919 and 1921 and increases the overassessment for the years 1918 and 1920 set forth in said Exhibit A as follows, to wit:

1918	$1,124.09
1919	1,484.91
1920	1,547.55
1921	464.39

The waiver of the right to have the taxes due for 1918 determined and assessed within five years after the return for such year was filed, was filed before June 15, 1924, and claim for refund relating to the taxes for the year 1918 was filed March 13, 1924.

Such a waiver in respect of taxes due for the taxable year 1919 was filed before June 15, 1925, and a claim for refund relating to taxes for said year 1919 was filed January 20, 1925.

Such waivers in respect of the taxes due for the taxable years 1920 and 1921 have been filed, and claims for refund relating to the taxes due for the years 1920 and 1921 were filed January 20, 1925.

4. The determination of the tax set forth in said notice of deficiency is based upon the following errors:

The Commissioner of Internal Revenue erred (a) in disallowing deduction for a loss sustained in 1917 on the dissolution and liquidation of Aluminum Sales & Manufacturing Company, the stock of which was held by petitioner and to which petitioner had prior to the dissolution advanced money and extended credit; and (b) in failing to give effect in subsequent years to the increases in invested capital resulting from the consequent reduction of taxes in 1917.

5. The facts upon which petitioner relies as a basis for the proceeding are as follows:

(a) In the year 1914 petitioner acquired all of the stock of Aluminum Sales & Manufacturing Company, paying therefor in cash $29,749.80. After acquiring said stock petitioner advanced moneys and extended credit to said Aluminum Sales & Manufacturing Company. Aluminum Sales & Manufacturing Company was dissolved in the year 1917, and petitioner continued to hold all of its stock until said dissolution and at the time of said dissolution was a creditor of said Aluminum Sales & Manufacturing Company in the sum of $47,486.31.

(b) Petitioner, being at the time of dissolution the sole owner of all the stock of Aluminum Sales & Manufacturing Company, acquired all the assets of said company, including good will and equipment. The good will of said company acquired by petitioner was of a value not in excess of $6,490.27, which was the basis at which said good will was computed in fixing the price of the stock of said Aluminum Sales & Manufacturing Company when the same was acquired by petitioner; and the equipment thus acquired by petitioner was of a value not in excess of $4,194.29, which was in excess of the value at which the same was computed in fixing the purchase price of the stock of Aluminum Sales & Manufacturing Company when acquired by petitioner.

(c) After applying the aggregate value of the good will and the equipment taken over as aforesaid, to wit: $10,684.56, against the indebtedness of Aluminum Sales & Manufacturing Company to the petitioner, a loss resulted to petitioner of $36,701.75, which, together with the loss of $29,749.80 paid in 1914 for the capital stock of said Aluminum Sales & Manufacturing Company, makes an aggregate loss of $66,551.55. Of this sum, $14,689.65 was returned and
6 allowed as an operating loss of Aluminum Sales & Manufacturing Company in 1917, and was reflected in the consolidated tax return of petitioner.

(d) To and including the year 1916 petitioner and the Aluminum Sales & Manufacturing Company made separate tax returns. During the years 1914, 1915, 1916, and 1917 the Aluminum Sales & Manufacturing Company sustained an operating loss each year, which

operating losses, with the exception of the operating loss in 1917, were not reflected in any return of the Aluminum Goods Manufacturing Company. The operating loss in the year 1917 was reflected in the consolidated tax return of the petitioner and Aluminum Sales & Manufacturing Company.

6. The claim of petitioner that it be allowed to deduct from its income the amounts above stated in subdivision (c) of paragraph 5 hereof, to-wit: $51,861.90 (being $66,551.$$, loss on liquidation, minus $14,689.65, operating loss of Aluminum Sales & Manufacturing Company in 1917, reflected in the consolidated return for that year) was duly presented to the Income Tax Unit of the Treasury Department and said unit decided against the claim of the petitioner. Thereupon, the petitioner, on or about the 9th day of December, 1922, appealed to the committee on appeals and review and said matter was duly presented to the committee on appeals and review on or about the 10th day of October, 1923, and the committee on appeals and review thereupon decided in favor of the claim of the petitioner, but said Income Tax Unit has failed and refused, in its computation of petitioner's income and excess profits tax for the year 1917, to give effect to the decision of the said committee on appeals and review and has refused to allow said losses for the year 1917 as aforesaid, and has computed the tax in disregard of said decision and has so notified petitioner.

Wherefore petitioner prays (a) that the United States Board of Tax Appeals may hear and redetermine the deficiency above referred to; (b) that the said deficiency in taxes for 1917 determined by the Commissioner of Internal Revenue be set aside; (c) that the sum of $24.811.54 included in claims for refund which were filed on the 5th day of February, 1923, and the 24th day of February, 1923, and the additional claim for refund presented to the Commissioner of Internal Revenue in March, 1923, be directed to be refunded to
7 petitioner; (d) that the United States Board of Tax Appeals determine that the income and excess profits tax of the petitioner for the year 1917 be computed after allowing as a deduction against the consolidated net income of the petitioner and Aluminum Sales & Manufacturing Company the sum of $51,861.90 on account of loss in connection with the stock of Aluminum Sales & Manufacturing Company, and on account of loss of the indebtedness of Aluminum Sales & Manufacturing Company to petitioner; (e) that the taxes for the years 1918 to 1921, both inclusive, be recomputed on the basis of increases in those years of the invested capital, made effective by the determination of the United States Board of Tax Appeals; that petitioner is entitled to the relief set forth under (a), (b), and (c) of this prayer for relief, and that the deficiency for 1919 and 1921 be decreased by the amounts of $1,484.91 and $464.39, respectively, and that the overassessment for the years 1918 and 1920 be

increased by the amounts of $1,1[illegible]4.09 and $1,547.55, respectively, as set forth in paragraph 3 of this petition; and (f) that your petitioner may have such other and further relief as may be just.

EDWIN S. MACK,
Council for Petitioner,
1504 First Wisconsin National Bank Building, Milwaukee, Wis.
WM. M. WILLIAMS,
PAUL F. MYERS,
E. B. QUIGGLE,
Attorneys for Petitioner,
Munsey Bldg., Washington, D. C.

[*Duly sworn to by R. J. Findlan; jurat omitted in printing.*]

8 *Exhibit A to petition*

MAR. 27, 1926.

IT:E:SM:60D
CH

ALUMINUM GOODS MANUFACTURING COMPANY,
15th and Franklin Streets, Manitowoc, Wisconsin.

SIRS: An audit of your income and profits tax returns for the years 1917 to 1921, inclusive, has resulted in the determination of a deficiency in tax of $86,436.18 for 1917, 1919, and 1921, and overassessments for 1918 and 1920 of $76,190.52, as shown in the attached statement.

In accordance with the provisions of section 274 of the revenue act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A,

9 and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of

IT:E:SM:60D
CH } In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR, *Commissioner.*

By ----------
Assistant to the Commissioner.

Enclosures:
Statement—Form 882
Waiver—Form A.
BS—1

MAR. 27, 1926.

Statement

IT:E:SM:60D
CH

In re: Aluminum Goods Manufacturing Company, Fifteenth and Franklin Streets, Manitowoc, Wisconsin.

Years examined	Deficiency in tax	Overassessment
1917	$5,438.57	
1918		$63,525.60
1919	66,119.06	
1920		12,604.84
1921	14,878.55	
Totals	86,436.18	76,190.52

Net deficiency in tax, $10,245.65.

After a careful review of your protests dated December 23, 1925, and January 18, 1926, against the denial of your application for assessment of your 1917 to 1921 profits tax under the provisions of Sections 210 and 327 and 328 of the Revenue Acts of 1917, 1918, and 1921, as set forth in Bureau letter dated November 27, 1925, and of all the evidence submitted in support of your contentions, the conclusion has been reached by the Bureau that no abnormality in either capital or income has been established as a fact.

10 In accordance with the above, the conclusions set forth in Bureau letter dated November 27, 1925, are sustained. Furthermore, the Bureau holds that the prior disallowance as a deduction from 1917 income of the loss sustained by the Sales Company is correct.

A copy of this communication has been forwarded to your authorized representative, Mr. Bert Vandervelde, Milwaukee, Wisconsin.
BS—1

Before U. S. Board of Tax Appeals

Amended Answer

Tendered May 14, 1929

Filed May 16, 1929

Comes now the Commissioner of Internal Revenue by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, and for an amended answer to the petition on appeal in the above-entitled proceeding admits, denies, and avers as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income and excess profits taxes for the calendar years 1917, 1919, and 1921.

Denies that the respondent determined any deficiencies for the calendar years 1918 and 1920, and avers that the board is without jurisdiction to hear and determine an appeal for these years, and moves, therefore, that the petition in so far is it relates to the years 1918 and 1920 be dismissed for lack of jurisdiction.

Admits that the statement accompanying the notice of deficiency states a deficiency of $5,438.57 for the year 1917.

Admits that a waiver covering the tax for 1917 was filed as alleged, but denies the materiality of said allegation.

Admits that claims for refund were filed for 1917, but denies the materiality of the allegation.

Admits that if error was made as alleged in paragraph 4
11 its correction would affect the tax liability for 1919 and 1921.

Avers that respondent not having determined a deficiency for 1918 or 1920 is required neither to admit nor deny the allegations relating to these years.

Admits that waivers and claims relating to the tax for 1919 and 1921 were filed as alleged, but denies the materiality of said allegations.

4. Denies that the respondent erred in determining the tax liability of petitioner for the years 1917, 1919, and 1921, as alleged in subparagraphs (a) and (b) of corresponding paragraph of the petition.

5. Admits and denies the allegations contained in corresponding paragraph of the petition, as follows:

(a) Admits that in the year 1914 petitioner acquired all of the stock of Aluminum Sales and Manufacturing Company, and admits that petitioner continued to hold said stock until the dissolution of the said Aluminum Sales and Manufacturing Company.

(b) Admits that petitioner being at the time of dissolution the sole owner of all the stock of Aluminum Sales and Manufacturing Company acquired all the assets of said company including goodwill and equipment.

(c) Admits that the sum of $14,689.65 was returned and allowed as an operating loss of Aluminum Sales and Manufacturing Company in 1917, and was reflected in the consolidated tax return of petitioner.

(d) Admits that the operating loss of the Aluminum Sales and Manufacturing Company in the year 1917 was reflected in the consolidated tax return of the petitioner and Aluminum Sales and Manufacturing Company.

6. Denies the materiality, relevancy, or competency of the allegations contained in corresponding paragraph of the petition, and avers that respondent is required neither to admit nor deny said allegations.

7. Avers that respondent erred in allowing as a deduction from the income of petitioner subject to normal tax for the year 1917 an alleged loss of $66,551.55 arising from the dissolution of the Aluminum Sales and Manufacturing Company. On information and belief respondent alleges that petitioner did not sustain any deductible loss during the year 1917 as the result of any dissolution of the Aluminum Sales and Manufacturing Company.

Denies generally and specifically each and every allegation in the petition contained not hereinbefore admitted, qualified, or denied.

12 Wherefore it is prayed that the appeal be denied and that the board determine that the income of petitioner for 1917 subject to normal tax should be increased by the sum of $66,551.55, and redetermine the tax accordingly.

(Signed) C. M. CHAREST,
C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel:
G. S. HERR,
Special Attorney,
Bureau of Internal Revenue.

Before U. S. Board of Tax Appeals

Statement of evidence

Lodged Sept. 1, 1931

Filed Sept. 3, 1931

The above cause came on for hearing before the Honorable John M. Sternhagen, member of the United States Board of Tax Appeals, on the sixth day of October, 1930, there being present the petitioner and respondent by their respective counsel.

Thereupon the following proceedings were had. After opening statements by counsel for petitioner and counsel for respondent there was introduced and filed as evidence in the case an agreed statement of facts, including Exhibit 1 attached thereto, which agreed statement of facts is as follows:

AGREED STATEMENT OF FACTS

1. Aluminum Goods Manufacturing Company, the petitioner, is a corporation organized in the year 1909 and existing under and by virtue of the laws of the State of New Jersey, with its principal office at Fifteenth & Franklin Streets, Manitowoc, Wisconsin. On March 27, 1926, the Commissioner of Internal Revenue mailed to the petitioner a notice of deficiency of income and excess profits taxes for the year ending December 31, 1917, a correct copy of which notice of deficiency is attached to the petition filed herein. The correct income and excess profits taxes of the petitioner for the years 1918, 1919, 1920, and 1921 are involved only in so far as such taxes are affected by a change in invested capital that may be
13 necessary on account of any change in the income and excess profits taxes of the petitioner for the year ending December 31, 1917, as may be found in this proceeding, the respondent by this stipulation, however, not admitting that the board has juridiction for the years 1918 and 1920.

2. The petitioner was a manufacturer and in the year 1914 it was selling its goods principally to jobbers. At that time the Aluminum Sales & Manufacturing Company (a New York Corporation), hereinafter called the Sales Company, was engaged in selling similar goods, principally to the retail trade, and during the year 1914 the petitioner purchased all the capital stock of the Sales Company, paying therefor in cash $29,749.80, as a business venture and for purposes of experimentation with the view of thereby acquiring a market to retailers. After the acquisition of its capital stock by petitioner, the Sales Company was operated as a jobbing house under the control of the petitioner, and the Sales Company sold, principally, goods manufactured by petitioner and sold by petitioner to the Sales Company, and the business of the Sales Company was almost exclusively that of furnishing an outlet for goods manufactured by petitioner.

3. The petitioner billed and delivered the goods to the Sales Company at its prevailing list price for that class of business. The goods were sold to retailers by the Sales Company and from the collections and its capital the Sales Company made remittances to petitioner for the goods purchased from the petitioner. The Sales Company conducted two places of business, one in Indianapolis, Indiana, and one in New York, New York. The Sales Company maintained a cash revolving fund of a fixed amount. When the Sales Company disbursed cash from time to time for the payment of operating expenses, such as rent, salaries, insurance, taxes, etc., the revolving fund was restored by advances from the petitioner.

4. The Indianapolis place of business of the Sales Company was discontinued during the year 1916 and at the end of that year the net unpaid cash advances to the Sales Company by petitioner for the use of that place of business amounted to $33,491.01.

5. During the year 1917 the New York place of business of the Sales Company was discontinued. Certain of the current assets of the Sales Company were thereupon taken over by the petitioner, the Sales Company receiving credit therefor on its open account with the petitioner. At the end of the year the net amount unre-
14 mitted to the petitioner for merchandise and cash furnished by the petitioner to the Sales Company for the use of that place of business was $13,995.30.

6. The net indebtedness of the Sales Company to petitioner as of the end of the year 1916 was $130,998.71, and at the end of the year 1917 said indebtedness had become reduced to $47,486.31, being the sum of the aforesaid amounts of $33,491.01 and $13,995.30, and the aforesaid sums of $33,491.01, and $13,995.30 never were repaid to the petitioner; and on its liquidation in 1917 Sales Company had no means with which to pay them, excepting the items of good will and equipment mentioned in paragraphs seven and twelve. Said sums were charged off by petitioner as follows: Said $33,491.01 December 30, 1916, and said $13,995.30 December 31, 1917.

7. The business of the Sales Company during the year 1917 consisted chiefly in finally closing up its affairs preparatory to formal dissolution. The Sales Company did not transact any business after the close of the year 1917, and all of its assets and liabilities were disposed of by the end of that year. In February, 1918, formal dissolution of the Sales Company was effected by the surrender of its charter. (See Exhibit 1, attached hereto and make a part hereof, being true copies of papers evidencing formal dissolution.) The petitioner being the sole owner of all of the capital stock of the Sales Company (the three individuals shown in Exhibit 1 being merely record owners) at the time of its liquidation in 1917, acquired all the assets of said company, including good will and equipment. The good will of said company acquired by petitioner was of a value of $6,490.27 which was the value placed upon the good will when petitioner purchased all the capital stock of the Sales Company in 1914, and the equipment thus acquired by petitioner was of a value of $4,194.29, exclusive of the items referred to in paragraph five. The good will and equipment were the only assets of any value acquired by the petitioner upon final liquidation of the Sales Company in 1917, and were the last remaining assets of the Sales Company. The Sales Company did not transact any business after the close of the year 1917, and all of its assets were completely disposed of during the year 1917, so that it had no assets whatsoever at the close of the year 1917. The petitioner charged off on its books all its investment in the capital stock of the Sales Company in the years 1916 and 1917, to wit: $11,025.47 December 31, 1916, and $18,724.33 December 31, 1917, making an aggregate of $29,749.80.

15 8. The operation of the Sales Company reflected losses during the years 1914, 1915, and 1916, which were not deducted in the determination of petitioner's net income for these

years, and the tax returns of the petitioner for said years included in its income a normal profit on the goods furnished by it to the Sales Company.

9. The operations of the Sales Company reflected a loss of $14,689.65 for the year 1917.

10. Up to and including the year 1916, the petitioner and the Sales Company made separate tax returns.

11. During the years 1914 to 1917, inclusive, the petitioner was the sole owner of all the capital stock of the Sales Company.

12. The petitioner filed a separate return for normal tax purposes, and a consolidated return with the Sales Company for excess profits tax purposes for the year 1917. On a separate amended return for 1917, petitioner claimed as a deduction a loss arising out of the liquidation of the Sales Company as follows:

Advances to Indianapolis office of Sales Co.	$33,491.01	
Advances to New York office of Sales Co.	13,995.30	$47,486.31
Investment in capital stock of Sales Co.		29,749.80
Total		77,236.11
Less: Value of good will and equipment received on liquidation of Sales Co.:		
Good will	6,490.27	
Equipment	4,194.29	10,684.56
Loss claimed and deducted		66,551.55

The respondent allowed this alleged loss in determining the net income subject to normal tax, as reflected in the deficiency notice.

13. In connection with the audit of its consolidated return for 1917, before the Bureau of Internal Revenue, the petitioner claimed a deductible loss of $51,861.90, being the difference between the alleged loss of $66,551.55 on liquidation of the Sales Company, less $14,689.65 operating loss of the Sales Company in 1917. The respondent in determining the net income subject to excess profits tax allowed the operating loss of $14,689.65 as such, as a deduction and disallowed the amount of $51,861.90. The deficiency de-

16 termined by the commissioner for the year 1917 is based upon a total tax liability as determined by the commissioner in the amount of $648,007.42, including normal taxes in the amount of $57,478.35 and excess-profits taxes in the amount of $590,529.07. The normal taxes were based upon petitioners' separate net income as determined by the commissioner in the amount of $1,548,501.62. The excess-profits taxes were based upon the consolidated net income and invested capital, as determined by the commissioner, of petitioner and said Sales Company for the entire calendar year 1917. Such consolidated net income was computed as follows:

Petitioner's net income as corrected	$1,548,501.62
Sales Company's net loss as corrected	14,689.65
Aggregate net income	1,533,811.97
Adjustments:	
Add loss on liquidation of Sales Co.	66,551.55
Consolidated net income for excess profits tax purposes	1,600,363.52

The total tax liability and the deficiency for the year 1917 were computed by the commissioner as follows:

Consolidated net income		1,600,363.52
Consolidated invested capital		3,075,742.09
Variable deduction		276,816.79
Specific exemption		3,000.00
Total deductions		279,816.79
Excess-profits tax (entire profit tax allocated to parent company)		590,529.07
Petitioner's taxable net income	$1,548,501.62	
Deduct excess-profits tax	390,529.07	
Taxable at 2%	957,972.55	19,159.45
Taxable at 4%	957,972.55	19,159.45
Total tax liability		648,007.42
Previously assessed		642,568.85
Deficiency		5,438.57

(Sgd.) PAUL MYERS,
Attorney for Petitioner.

(Sgd.) C. M. CHAREST (MBL),
Attorney for Respondent.

17 Exhibit 1 attached to said agreed statement of facts was a duly authenticated and certified copy of the certificate of dissolution of the Aluminum Sales and Manufacturing Company, Inc., filed with the secretary of state of the State of New York on the 21st day of February, 1918. The said certificate was signed and sworn to on the 11th day of February, 1918, by George Vits and M. C. Hermann, president and secretary, respectively, of Aluminum Sales and Manufacturing Company, Inc.; purported to be for the purpose of complying with the provisions of section 221 of the general corporation law of the State of New York in relation to the voluntary dissolution of corporations; and was to the following effect:

That on the 10th day of January, 1918, the board of directors of said corporation duly adopted resolutions that the corporation be dissolved forthwith in the manner prescribed by section 221 of the general corporation law of the State of New York, that a meeting of the stockholders be held on the 11th day of February, 1918, for the purpose of voting on the question of dissolution, and that the president and secretary and the officers and directors take such further action as might be required to effect the dissolution of the corporation and wind up its business and affairs;

That at a meeting of the stockholders of said corporation held on the 11th day of February, 1918, pursuant to waivers and consents in writing signed by all the stockholders, the following resolution was duly adopted by the affirmative vote of the holders of all the shares of stock of said corporation issued and outstanding, to wit: 250 shares:

"Resolved, That the resolution of the board of directors, adopted at the meeting of said board held on the tenth day of January, 1918, in favor of the immediate dissolution of this corporation be and they are hereby approved, and that the holders of two hundred and fifty (250) shares of the capital stock of said Aluminum Sales and Manufacturing Company, Inc., hereby consent that said corporation be dissolved forthwith, pursuant to the provisions of section 221 of the general corporation law of the State of New York, and that the officers and directors of the company be and they are hereby authorized to take all necessary and proper action to effectuate such dissolution and to wind up the business and affairs of the company, and that we hereby signify our consent in writing to such dissolution in conformity with the provisions of said statute."

That at said meeting the holders of 250 shares, being the
18 entire amount of the stock of said corporation then issued and outstanding, signified their consent in writing that such corporation be dissolved forthwith.

Attached to said certificate and made a part thereof were the following:

The consent in writing of all the stockholders of said corporation that said corporation be dissolved forthwith pursuant to section 221 of the general corporation law of the State of New York, the same being signed as follows:

Names of stockholders:	Number of shares
George Vits	Two hundred and forty-eight.
A. J. Vits	One.
M. C. Herrmann	One.

(The equitable owner of the said stock was the Aluminum Goods Manufacturing Company as shown in the agreed statement of facts.)

A statement under oath by the secretary of the said corporation certifying to the names and residences of the directors and the names of the officers of said corporation;

A waiver of notice dated January 10, 1918, signed by the directors and consenting that the meeting of the board of directors be held on said date without further notice; and

A waiver of notice by the stockholders of said corporation signed by the above-named stockholders on the 10th day of January, 1918, consenting that a meeting of the stockholders be held on the 11th day of February, 1918, for the purpose of voting on the proposition that the corporation be dissolved.

The said agreed statement of facts, and said Exhibit No. 1 digested and summarized as above, was all the evidence introduced on behalf of the petitioner and the respondent in this case.

The case was then argued by counsel for the respondent and was thereupon submitted to the member of the United States Board of Tax Appeals hearing the proceeding, with leave to counsel for the petitioner to file a written brief.

The petitioner, Aluminum Goods Manufacturing Company, tenders and presents the foregoing as a statement of the evidence in this case and prays that the same be approved by the United States Board of Tax Appeals and made a part of the record in this cause.

(Signed) EDWIN S. MACK,
PAUL F. MYERS,
Attorneys for Petitioner.

19 Before U. S. Board of Tax Appeals

Agreement to statement of evidence under equity rule 75

We have examined and read the foregoing nine pages comprising a statement of the evidence taken in the case of Aluminum Goods Manufacturing Company, petitioner, vs. Commissioner of Internal Revenue, respondent, Docket No. 15814, in the United States Board of Tax Appeals; said evidence consisting of an agreed statement of facts introduced before the said board with exhibit mentioned therein as Exhibit 1 and attached thereto. We agree that all parties hereby have received due and legal notice of said statement as required by Equity Rule No. 75, and we accept service of such notice and hereby waive further notice of the filing of the statement, and we agree that said statement as made may be approved by the board member hearing the case, without further notice to any party hereto, and that when so approved may be filed in the clerk's office and become a part of the record for the purpose of the petition for review in said cause filed by Aluminum Goods Manufacturing Company, petitioner.

(S) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

Dated Sept. 1st, 1931.

Before U. S. Board of Tax Appeals.

Order approving statement of evidence

I hereby certify that the foregoing statement of evidence has been examined by me and found conformable to the truth and contains all the evidence in the case deemed essential to the decision of the questions presented by the petition for review.

Said statement of evidence on the petition for review of the Aluminum Goods Manufacturing Company is hereby approved and signed and ordered to be made of record in the above-entitled cause this 3d day of Sept., 1931.

(S) J. M. STERNHAGAN,
Member, United States Board of Tax Appeals.

20 Before U. S. Board of Tax Appeals

Promulgated February 2, 1931

A true copy: Teste—B. D. Gamble, clerk U. S. Board of Tax Appeals.

Where in 1917 one corporation owned all the stock of another and a consolidated return was filed in accordance with section 1331, revenue act of 1921, intercompany losses during the period of affiliation by reason of advances by one company to the other and the ownership of stock were not deductible in determining income subject to profits tax. Utica Knitting Co. v. United States, 68 Ct. Cls. 77, followed.

Paul F. Myers, Esq., for the petitioner.

F. R. Shearer, Esq., for the respondent.

Opinion

Filed Feb. 2, 1931

Sternhagen: This proceeding involves deficiencies of $5,438.57, $66,119.06, and $14,878.55 in profits taxes for 1917, 1919, and 1921, respectively. Petitioner seeks to deduct on its consolidated profits tax return for 1917 the cost of stock and amount of unpaid advances made to its liquidated but undissolved subsidiary, and to carry the effect of such deduction into the computation of invested capital for later years. The case was submitted on the following agreed statement of facts:

1. Aluminum Goods Manufacturing Co., the petitioner, is a corporation organized in the year 1909 and existing under and by virtue of the laws of the State of New Jersey, with its principal office at Fifteenth and Franklin Streets, Manitowoc, Wisconsin. On March 27, 1926, the Commissioner of Internal Revenue mailed to the petitioner a notice of deficiency of income and excess-profits taxes for the year ending December 31, 1917, a correct copy of which notice of deficiency is atached to the petition filed herein. The correct income and excess profits taxes of the petitioner for the years 1918, 1919, 1920, and 1921 are involved only in so far as such taxes are
21 affected by a change in invested capital that may be necessary on account of any change in the income and excess profits taxes of the petitioner for the year ending December 31, 1917, as may be found in this proceeding, the respondent by this stipulation, however, not admitting that the Board has jurisdiction for the years 1918 and 1920.

2. The petitioner was a manufacturer and in the year 1914 it was selling its goods principally to jobbers. At that time the Aluminum Sales & Manufacturing Company (a New York corporation), hereinafter called the Sales Company, was engaged in selling similar goods, principally to the retail trade, and during the year 1914 the

petitioner purchased all the capital stock of the Sales Company paying therefor in cash $29,749.80, as a business venture and for purposes of experimentation with the view of thereby acquiring a market to retailers. After the acquisition of its capital stock by petitioner, the Sales Company was operated as a jobbing house under the control of the petitioner, and the Sales Company sold, principally, goods manufactured by petitioner and sold by petitioner to the Sales Company, and the business of the Sales Company was almost exclusively that of furnishing an outlet for goods manufactured by petitioner.

3. The petitioner billed and delivered the goods to the Sales Company at its prevailing list price for that class of business. The goods were sold to retailers by the Sales Company and from the collections and its capital the Sales Company made remittances to petitioner for the goods purchased from the petitioner. The Sales Company conducted two places of business, one in Indianapolis, Indiana, and one in New York, New York. The Sales Company maintained a cash revolving fund of a fixed amount. When the Sales Company disbursed cash from time to time for the payment of operating expenses, such as rent, salaries, insurance, taxes, etc., the revolving fund was restored by advances from the petitioner.

4. The Indianapolis place of business of the Sales Company was discontinued during the year 1916 and at the end of that year the net unpaid cash advances to the Sales Company by petitioner for the use of that place of business amounted to $33,491.01.

5. During the year 1917 the New York place of business of the Sales Company was discontinued. Certain of the current assets of the Sales Company were thereupon taken over by the petitioner, the Sales Company receiving credit therefor on its open account
22 with the petitioner. At the end of the year the net amount unremitted to the petitioner for merchandise and cash furnished by the petitioner to the Sales Company for the use of that place of business was $13,995.30.

6. The net indebtedness of the Sales Company to petitioner as of the end of the year 1916 was $130,988.71, and at the end of the year 1917 said indebtedness had become reduced to $47,486.31, being the sum of the aforesaid amounts of $33,491.01 and $13,995.30, and the aforesaid sums of $33,491.01 and $13,995.30 never were repaid to the petitioner; and on its liquidation in 1917, Sales Company had no means with which to pay them, excepting the items of good will and equipment mentioned in paragraphs seven and twelve. Said sums were charged off by petitioner as follows: Said $33,491.01 December 30, 1916, and said $13,995.30 December 31, 1917.

7. The business of the Sales Company during the year 1917 consisted chiefly in finally closing up its affairs preparatory to formal dissolution. The Sales Company did not transact any business after the close of the year 1917, and all of its assets and liabilities were disposed of by the end of that year. In February, 1918, formal

dissolution of the Sales Company was effected by the surrender of its charter. (See Exhibit 1, attached hereto and made a part hereof, being true copies of papers evidencing formal dissolution.) The petitioner being the sole owner of all of the capital stock of the Sales Company (the three individuals shown in Exhibit 1 being merely record owners) at the time of its liquidation in 1917, acquired all the assets of said company, including good will and equipment. The good will of said company acquired by petitioner was of a value of $6,490.27 which was the value placed upon the good will when petitioner purchased all the capital stock of the Sales Company in 1914, and the equipment thus acquired by petitioner was of a value of $4,194.29, exclusive of the items referred to in paragraph five. The good will and equipment were the only assets of any value acquired by the petitioner upon final liquidation of the Sales Company in 1917, and were the last remaining assets of the Sales Company. The Sales Company did not transact any business after the close of the year 1917, and all of its assets were completely disposed of during the year 1917, so that it had no assets whatsoever at the close of the year 1917. The petitioner charged off on its books all its investment in the capital stock of the Sales Company in the
23 years 1916 and 1917, to wit: $11,025.47 December 31, 1916, and $18,724.33 December 31, 1917, making an aggregate of $29,749.80.

8. The operations of the Sales Company reflected losses during the years 1914, 1915, and 1916, which were not deducted in the determination of petitioner's net income for these years, and the tax returns of the petitioner for said years included in its income a normal profit on the goods furnished by it to the Sales Company.

9. The operations of the Sales Company reflected a loss of $14,689.65 for the year 1917.

10. Up to and including the year 1916, the petitioner and the Sales Company made separate tax returns.

11. During the years 1914 to 1917, inclusive, the petitioner was the sole owner of all the capital stock of the Sales Company.

12. The petitioner filed a separate return for normal tax purposes, and a consolidated return with the Sales Company for excess profits tax purposes for the year 1917. On a separate amended return for 1917, petitioner claimed as a deduction a loss arising out of the liquidation of the Sales Company as follows:

Advances to Indianapolis office of Sales Co	$33,491.01	
Advances to New York office of Sales Co	13,995.30	
		$47,486.31
Investment in capital stock of Sales Co		29,749.80
Total		77,236.11
Less: Value of good will and equipment received on liquidation of Sales Co:		
Goodwill	$6,490.27	
Equipment	4,194.29	
		10,684.56
Loss claimed and deducted		66,551.55

The respondent allowed this alleged loss in determining the net income to normal tax, as reflected in the deficiency notice.

13. In connection with the audit of its consolidated return for 1917, before the Bureau of Internal Revenue, the petitioner claimed a deductible loss of $51,861.90, being the difference between the alleged of $66,551.55 on liquidation of the Sales Company, less $14,689.65 operating loss of the Sales Company in 1917. The
24 respondent in determining the net income subject to excess profits tax allowed the operating loss of $14,689.65 as such, as a deduction and disallowed the amount of $51,861.90. The deficiency determined by the commissioner for the year 1917 is based upon a total tax liability as determined by the commissioner in the amount of $648,007.42, including normal taxes in the amount of $57,478.35, and excess profits taxes in the amount of $590,529.07. The normal taxes were based upon petitioner's separate net income as determined by the commissioner in the amount of $1,548,501.62. The excess profits taxes were based upon the consolidated net income and invested capital, as determined by the commissioner, of petitioner and said Sales Company for the entire calendar year 1917. Such consolidated net income was computed as follows:

Petitioner's net income as corrected	$1,548,501.62
Sales Company's net loss as corrected	14,689.65
Aggregate net income	1,533,811.97
Adjustments: Add loss on liquidation of Sales Co	66,551.55
Consolidated net income for excess profits tax purposes	1,600,363.52

The total tax liability and the deficiency for the year 1917 were computed by the commissioner as follows:

Consolidated net income		$1,600,363.52
Consolidated invested capital		3,075,742.09
Variable deduction		276,816.79
Specific exemption		3,000.00
Total deductions		279,816.79
Excess-profits tax (entire profit tax allocated to parent company)		590,529.07
Petitioner's taxable net income	$1,548,501.62	
Deduct excess profits tax	590,529.07	
Taxable at 2%	957,972.55	19,159.45
Taxable at 4%	957,972.55	38,318.90
Total tax liability		648,007.42
Previously assessed		642,568.85
Deficiency		5,438.57

25 In all essential respects the facts and contentions are the same as those in Utica Knitting Co. v. United States, 88 Ct. Cls. 77. The court sustained the Commissioner's disallowance of the deductions for loss both as to advances and cost of stock, holding that in respect of corporations affiliated in 1917 in accordance with section 1331, revenue act of 1921, intercompany losses during the period of affiliation were not deductible in determining income subject to profits tax, even though deduction was permitted in deter-

mining separately the taxable net income of one corporation of the group subject to income tax. The Supreme Court denied certiorari, 281 U. S. 739. There is no contrary view of similar facts and we follow that decision.

The decisions in Remington Rand, Inc., 33 Fed. (2d) 77; United Publishers Corporation v. Anderson, 42 Fed. (2d) 787; and Riggs National Bank, 17 B. T. A. 615, are not in point since they all deal with situations where the affiliation ceased in the year in question, while here the petitioner continued to own all the Sales Company stock and filed a consolidated return, and it is not contended that the statutory affiliation ceased before the following year. Alpha Portland Cement Co. v. United States, 44 Fed. (2d) 92, related to the deduction by the affiliated group of the cost of assets which had become worthless and were abandoned.

As to 1918 and 1920, no deficiency has been determined and the board lacks jurisdiction. Cornelius Cotton Mills, 4 B. T. A. 253. For those years the proceedings will be dismissed.

For 1917, 1919, 1921, judgment will be entered for the respondent.

Before U. S. Board of Tax Appeals

Supplemental Memorandum Opinion

Filed Feb. 4, 1931

Paul F. Myers, Esq., for the petitioner.
F. R. Shearer, Esq., for the respondent.

Sternhagen: The respondent's counsel by motion has brought to our attention the omission from the report of February 2, 1931, of any disposition of the affirmative averment that no loss was sustained by petitioner in 1917 deductible in determining net income subject to ordinary income tax, and that respondent erred in allowing such deduction of $66,551.55 in respect of 1917 income tax. At the
26 hearing, counsel for respondent narrowed this issue to the contention that under the stipulated facts it was improper to allow the deduction in 1917 of the item of $33,491.01 described as advances to the Indianapolis place of business.

The respondent contends that this amount was a debt from the Sales Company to the petitioner which could only be deducted when it was both ascertained to be worthless and charged off, and that since it is stipulated in paragraph 6 that this amount was charged off December 30, 1916, it was not properly deductible in 1917. But we are unable to say surely that the "advance" of $33,491.01 was in 1916 a worthless debt within the meaning of revenue act of 1916, section 5, paragraph 6, or that it was "charged off" within the meaning of that section. The commisioner had held otherwise and paragraph 6 of the stipulation is to some extent ambiguous. It begins by saying that the amount of $33,491.01 was included in the net indebtedness of the sales Company to the petitioner at the end of 1917, and ends by saying that this amount had been charged off on December 30, 1916.

In this doubtful statement of facts, there is insufficient justification for modifying the commisisoner's determination, and the judgment will be entered for the deficiencies as shown by the deficiency notice.

Enter:

Entered Feb. 4, 1931.

Before U. S. Board of Tax Appeals

Order of dismissal and judgment

Entered Feb. 6, 1931

Pursuant to the boards opinion promulgated February 2, 1931, and supplemental memorandum opinion of February 4, 1931, it is

Ordered that the proceeding be and it hereby is dismissed in respect of the years 1918 and 1920 for lack of jurisdiction; and it is further

Ordered, adjudged, and decided that there are deficiencies in profits taxes of $5,438.57 for 1917, $66,119.06 for 1919, and $14,878.55 for 1921.

Enter:

(Signed) JOHN M. STERNHAGEN,
[SEAL.] *Member, United States Board of Tax Appeals.*

27 8—7/27/31. Petition for review by Circuit Court of Appeals (Seventh Circuit).

In United States Circuit Court of Appeals, Seventh Circuit

Petition for review

Filed July 31, 1931

To the honorable the Chief Justice and the Associated Justices of the United States Circuit Court of Appeals for the Seventh Circuit:

Your petitioner is aggrieved by a decision of the United States Board of Tax Appeals, rendered against it February 6, 1931, in the case of Aluminum Goods Manufacturing Company v. Commissioner of Internal Revenue, No. 15814 on the Docket of the Board, 22 B. T. A. 1, and respectfully submits its petition for review thereof by the United States Circuit Court of Appeals for the Seventh Circuit.

STATEMENT OF CASE

(1) Petitioner is a corporation organized in the year 1909, and existing under and by virtue of the laws of the State of New Jersey, with its principal office at 15th and Franklin Streets, Manitowoc, Wisconsin. Its income and excess profits tax returns for the year 1917 and for all years subsequent thereto have been filed with and all resulting assessments paid to the collector of internal revenue for the district of Wisconsin with offices at Milwaukee, Wisconsin.

The Commissioner of Internal Revenue determined that there were deficiencies in taxes for the years 1917, 1919, and 1921, and overassessments for the years 1918 and 1920, and sent notice thereof to the petitioner by registered mail on or about March 27, 1926. Thereafter, on or about May 10, 1926, said corporation duly petitioned the United States Board of Tax Appeals for a redetermination of said asserted deficiencies and overassessments.

The deficiency for 1917, asserted by the *d*espondent, is $5,438.57. The amount of tax in controversy for said year, however, is $29,250.11, as the petitioner claimed and claims that it overpaid the said tax in the amount of $23,811.54.

The respondent having also asserted deficiencies for the
28 years 1919 and 1921, the profits taxes for these years are in controversy, but only so far as such taxes are affected by a change in invested capital which necessarily follows as a result of any change in the income and excess profits taxes of the petitioner for the year 1917. The amount of excess profits taxes so in controversy for the years 1919 and 1921 are $1,484.91 and $464.39, respectively.

2 (a). The petitioner, in 1914, purchased all of the capital stock of the Aluminum Sales & Manufacturing Company, a New York corporation, paying $29,749.80 therefor in cash. Petitioner is and was then a manufacturer, and the said New York corporation was engaged as a jobber of similar goods. During the years 1914, 1915, 1916, and 1917 petitioner advanced sums of money to the said subsidiary. In 1916 the said subsidiary was partially liquidated and in 1917 the liquidation was completed and its remaining assets and liabilities were disposed of to the petitioner. The subsidiary's business during 1917 consisted chiefly in closing up its affairs. The formal dissolution of the said subsidiary was effected in February, 1918, by the surrender of its charter, and it did not transact any business in 1918. Petitioner suffered a loss in 1917 upon the liquidation of the said subsidiary. The said loss is as follows:

Investment by petitioner in the capital stock of the subsidiary	$29,749.80
Excess net advances made by petitioner to the subsidiary over the amount received by the petitioner in the final liquidation of the subsidiary in 1917	36,801.75
	66,551.55
Deduct 1917 operating losses of subsidiary allowed by commissioner	14,689.65
Net amount properly allowable to petitioner as deductible loss	51,861.90

(b) For the year 1917, the petitioner and its subsidiary filed separate returns of income for normal tax purposes and a consolidated return for excess profits tax purposes. The respondent allowed the said loss in determining the net income subject to normal tax, but erroneously disallowed the said loss in the determination of the net income subject to excess profits tax for said year.

29 3. In determining petitioner's net income for 1919 and 1921, the respondent reduced petitioner's otherwise undisputed in-

vested capital for said years by the amount of the additional taxes erroneously asserted for 1917 as aforesaid, which erroneous reduction of invested capital resulted in past in the determination of the aforesaid deficiencies in the amount of petitioner's excess profits taxes for the years 1919 and 1921.

4. This is a petition for review of a decision of the United States Board of Tax Appeals entered on February 6, 1931, wherein said board approved deficiencies in excess profits taxes for 1917, 1919, and 1921 as asserted by the respondent, and held that such loss as above set forth was not deductible in determining income subject to profits tax even though such deduction was permitted in determining separately the taxable net income, subject to income tax, of one corporation of the group.

Your petitioner believes and avers that errors were committed by the United States Board of Tax Appeals to its damage as shown by the following:

ASSIGNMENTS OF ERROR

(1) The Board of Tax Appeals erred in holding that said loss of $51,861.90 resulting from the liquidation of the said subsidiary was not deductible in determining petitioner's consolidated net income subject to excess profits tax for the year 1917.

(2) The Board of Tax Appeals erred in affirming respondent's determination of invested capital for the years 1919 and 1921, in so far as the said invested capital was reduced by the deduction of the alleged additional taxes for 1917 which were erroneously determined as aforesaid.

(3) The Board of Tax Appeals further erred in failing to set aside the deficiency asserted by the commissioner for 1917 and in failing to set aside the deficiencies asserted for the years 1919 and 1921 in so far as such latter alleged deficiencies result from a decrease in invested capital arising from an erroneous increase in excess profits taxes for 1917.

(4) The Board of Tax Appeals further erred in failing to find an overpayment of $23,811.54 by petitioner of its excess profits taxes for the year 1917.

Wherefore your petitioner prays that the decision of the United States Board of Tax Appeals entered against it be reviewed and reversed by this honorable court, and for such other and further relief as the court may deem just and proper in the premises.

ALUMINUM GOODS MANUFACTURING COMPANY,
By A. J. VITS, *Vice President.*
EDWIN S. MACK, *Attorney for Petitioner.*
MILLER, MACK, & FAIRCHILD, *Of Counsel.*

[*Duly sworn to by A. J. Vits; jurat omitted in printing*]

BEFORE U. S. BOARD OF TAX APPEALS

Notice of filing petition for review

Filed July 31, 1931

To: D. M. CHAREST, Esq.
General Counsel, Bureau of Internal Revenue,
Attorney for the Respondent.

You are hereby notified that a petition for review in the
31 above-entitled cause was filed with the United States Board of Tax Appeals on the 31st day of July, 1931.

A copy of said petition is served upon you herewith.

MILLER, MACK, & FAIRCHILD,
Milwaukee, Wisconsin,
PAUL F. MYERS,
Munsey Bldg., Washington, D. C.
Attorneys for Petitioner.

Service accepted this 31st day of July, 1931.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

Before U. S. Board of Tax Appeals

Præcipe for Transcript

Filed Sept. 1, 1931

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of record in this cause and on or before September 29, 1931, transmit and deliver the same to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, and include in said transcript copies duly certified as correct of the following documents:

(1) The docket entries of proceedings before the board in the above-entitled cause.

(2) Petition for redetermination filed on May 10, 1926.

(3) Amended answer to petition filed on May 16, 1929.

(4) Opinion of the board, including agreed statement of facts, promulgated on February 2, 1931.

(5) Supplemental memorandum opinion of the board entered on February 4, 1931.

(6) Order of dismissal and judgment entered February 6, 1931.

(7) Petition for review filed July 31, 1931.

(8) Notice of filing petition for review with acknowledgment of service thereon by the general counsel, bureau of Internal Revenue, filed July 31, 1931.

32 (9) Statement of evidence approved and filed Sept. 1st, 1931.

(10) This præcipe for transcript.

Said transcript to be prepared as required by law and the rules of the U. S. District Court of Appeals for the Seventh Circuit.

(Signed) PAUL F. MYERS,
EDWIN S. MACK,
Attorneys for petitioner.

[Clerks' certificate to foregoing transcript omitted in printing.]

[Appearances of counsel omitted in printing.]

[Appearances of counsel omitted in printing.]

[Order setting cause for hearing omitted in printing.]

[Appearances of counsel omitted in printing.]

[Minute entry of argument and submission, Jan. 27, 1932, omitted in printing.]

[Appearances of counsel omitted in printing.]

38 In United States Circuit Court of Appeals for the Seventh Circuit

No. 4642. October Term, 1931, January Session, 1932

Aluminum Goods Manufacturing Company, petitioner, *vs.* Commissioner of Internal Revenue, respondent. Petition for review of order of United States Board of Tax Appeals

Opinion filed

February 25, 1932

Before EVANS and SPARKS, circuit judges, and BALTZELL, district judge.

EVANS, Circuit Judge: Petitioner's income and profits taxes for the years 1917, 1919, and 1921 are involved on this appeal. The dispute over the 1917 tax arises out of a loss suffered by petitioner through the liquidation of its subsidiary which had become insolvent. Petitioner asserts that it has overpaid its 1917 tax and seeks a refund. Respondent contends, and the Board of Tax Appeals sustained his view, that an additional tax was due for this year. Dispute over the 1919 and 1921 taxes arises over the item of invested capital. It is conceded by respondent that if petitioner's contention respecting the 1917 tax be corrected, the 1919 and 1921 taxes must likewise be corrected because a changed invested capital would necessitate a different basis of computation.

The Facts: Petitioner, an aluminum manufacturing company, in 1914, purchased the entire capital stock of the Aluminum Sales
39 Company for $29,749.80. The Sales Company operated at a loss during 1914, 1915, 1916, and 1917. Its operating loss for the last year was $14,689.65. The loss which petitioner seeks to deduct arises from loans or advances, aggregating $47,486.31, and its investment in the subsidiary's stock—$29,749.80, less $10,684.56, which it received in equipment and good will upon the subsidiary's liquidation. Deducting $14,689.65, operating loss of the Sales Company in 1917, which respondent allowed, there is left a net loss of $51,861.90 sought to be deducted.

Up to and including 1916, the petitioner and the subsidiary filed separate returns. In 1917, they filed separate returns for normal tax purposes and a consolidated return for excess profits tax purposes. In the computation of the petitioner's income for normal taxes upon the separate return for 1917, the commissioner allowed a deduction of the entire loss incurred upon the liquidation of the subsidiary, but for excess profits tax purposes he only allowed a deduction of $14,689.65, the operating loss of the subsidiary for 1917.

The Board of Tax Appeals found that—

"The business of the Sales Company during the year 1917 consisted chiefly in finally closing up its affairs preparatory to formal dissolution. The Sales Company did not transact any business after the close of the year 1917, and all of its assets and liabilities were disposed of by the end of that year. In February, 1918, formal dissolution of the Sales Company was effected by the surrender of its charter."

The board held that the loss of $51,681.90, which arose from the liquidation of the subsidiary, was not deductible in determining the excess profits tax.

It is conceded that the entire loss was deductible, if at all, in the year 1917. Respondent, however, contends that the loss sought to be deducted is a loss resulting from intercompany transactions and therefore not allowable upon a consolidated return. The basis of his argument is that the transfer to the parent company of all the assets of the subsidiary is insufficient to terminate affiliation and that the loss sustained was from an intercompany transaction. Petitioner argues that a loss suffered upon liquidation of a subsidiary is outside the period of the affiliation, and also that the loss did not arise from an intercompany transaction.

The revenue act of 1917 provided for an excess profits tax,
40 in addition to the taxes already existing, upon the income of every corporation, and gave to the commissioner power to promulgate necessary rules and regulations (secs. 4, 201, 206, and 213). The revenue act of 1921 provided that the act of 1917 should be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of corporations affiliated during 1917, and defined the term "affiliation" so as to include wholly owned subsidiaries.

The purpose and advantages of consolidated returns are obvious. The determination of the tax assessed thereon proceeds on the theory that in ascertaining taxable income the Government looks beyond the outward form to the business activities of the entities and levies a tax on the business unit although said business is conducted by two corporations. But provisions for the making of a consolidated return by the affiliated companies do not affect the section of the statute which defines gains and losses. These definitions are to be found in other sections of the internal revenue act. Section 12 (a), Title I, of the revenue act (a provision found in every income tax act) provides for the deduction from gross income of "all losses actually sustained and charged off within the year."

In the instant case, it is impossible to escape the conclusion that petitioner suffered a loss. That the loss was sustained in 1917, if at all, is admitted. The conclusion seems too obvious to require argument—that a company which buys stock in 1914, paying $29,749.80 in cash therefor, loses that amount upon the company's selling all of its assets, including good will, realizing a sum less than its debts. Likewise, if A loans money at different times to B, and B sells all of its assets and realizes only a fraction of its indebtedness, then A loses the difference between the sum total of its loans and the amount it received upon the liquidation of B's assets.

Refusal to recognize these losses, respondent argues, is due to the fact that said losses are traceable to intercompany transactions of the affiliated companies. No statutory authority is cited to support this position, but practice in the Internal Revenue Department has resulted in the disallowance of such losses which grow out of strictly intercompany transactions. Such practice found expression in Regulations 62, art. 636, and Regulations 65, art. 636. The practice can be sustained only in so far as it does not run counter to the pro-
41 visions of the statute. No rule or practice of the department can be sustained which defines a profit or a loss differently from that of the statute. The practice of accountants of ignoring a loss of one affiliated company when it is compensated by a gain of the other affiliated company and when so limited, is eminently sound. As A and B (two affiliated companies) for tax purposes are one, a loss to one which is represented by a gain to the other should be ignored. Such transactions are called intercompany transactions. But a loss to A not compensated by a gain to B is a loss which A should be permitted to deduct even though A and B file a consolidated return. Strictly speaking, such a transaction is not an intercompany transaction.

Petitioner's purchase of the stock of the Sales Company was not an intercompany transaction. At the time of the purchase, the two companies were not affiliated. Neither was the purchase of the stock from a third party a transaction with the subsidiary company.

Likewise, the losses of the Sales Company grew out of its conduct of its business; that is, its cost of operation and the losses on its

account due to sales to third parties. The loans were never repaid because of such losses by the Sales Company to third parties. In the only instance when the Sales Company claimed an operating loss, the amount of said loss was deducted.

Authorities, save Utica Knitting Company v. U. S., 68 Ct. Cls. 77, sustain this understanding of an intercompany loss. The same authorities (Remington-Rand, Inc. v. Commissioner, 33 F. (2d) 77; United Publishers Corp. v. Anderson, 42 F. (2d) 787; Riggs National Bank v. Commissioners, 17 B. T. A. 615; Wilmington Steamboat Company v. Sturgess, 52 F. (2d) 210 (D. C. N. J.) affirmed on appeal; Canal-Commercial National Bank v. Commissioner, 22 B. T. A. 541; American Printing Company v. United States, 51 F. (2d) 98 (D. C. Mass.); American Paper Exports, Inc. v. Bowers, (C. C. A. 2) decided December 14, 1931) sustain a holding that liquidation of the Sales Company ipso facto terminates the affiliation of the two companies. The basis for these decisions seems sound. The statute governing affiliated returns contemplated its application to active companies only. It would be a legal and commercial impossibility for a going corporation to affiliate with a corpse—the mere shell of a former corporation. The activities of a dissolved corporation are nil. Its assets amount to a cipher. To add nullities and a
42 cipher to a live company's capital and to its operation would produce no change in the return.

In the instant case, evidence was produced to show, and the board found, that the Sales Company was legally dissolved immediately following its liquidation. In other words, its burial followed shortly after its demise. To ascertain when the status of affiliation terminates, attention is directed to the subsidiary's death, not to its burial.

Had petitioner upon the liquidation of the subsidiary realized a sum in excess of the amount it paid for the stock, it would be, as was held in American Printing Company v. U. S., supra, chargeable with the excess for the year in which it was received. It follows that if a taxpayer be chargeable with the profits growing out of such a transaction, it should likewise be credited with a loss if the sum realized upon liquidation be less than the amount it paid for the stock.

Our conclusions are: That affiliation between petitioner and the Sales Company was terminated by the latter company's liquidation; that the loss which petitioner sustained in its purchase of the stock of the Sales Company was clearly not an intercompany transaction; that the loss petitioner sustained through its loans and advances to the Sales Company was not sustained in an intercompany transaction; that both losses occurred outside the period of the affiliation of the two companies.

The order of the Board of Tax Appeals is reversed with directions to said board to redetermine petitioner's 1917, 1919, and 1921 taxes in accordance with the views herein expressed.

43 In United States Circuit Court of Appeals

Aluminum Goods Manufacturing Company vs. Commissioner of Internal Revenue. Petition for review of order of the United States Board of Tax Appeals

Judgment

Feb. 25, 1932

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the order of the United States Board of Tax Appeals in this cause, entered on February 6, 1931, be, and the same is hereby reversed; and that this cause be, and the same is hereby remanded to the said United States Board of Tax Appeals with directions to redetermine petitioner's 1917, 1919 and 1921 taxed in accordance with the views expressed in the opinion of this court.

44 In United States Circuit Court of Appeals

[Title omitted.]

Motion for order extending time filed March 13, 1932

Now comes the respondent, by Dwight H. Green, special attorney, Bureau of Internal Revenue, his attorney, and moves the court for an order extending the time within which a petition for rehearing may be filed by the respondent to and including March 26, 1932.

DWIGHT H. GREEN,
Special Attorney, Bureau of Internal Revenue,
Attorney for Respondent.

[File indorsement omitted.]

45 In United States Circuit Court of Appeals

[Title omitted.]

Order extending time

March 16, 1932

On motion of counsel for respondent, it is now here ordered that the time for filing petition for rehearing in this cause be, and the same is hereby extended to and including March 26, 1932.

Memoranda re petition for rehearing and answer thereto

And afterwards, to wit, on the nineteenth day of March, 1932, there was filed in the office of the clerk of this court a petition for a rehearing, which said petition for a rehearing is not copied here.

And afterwards, to wit, on the twenty-ninth day of March, 1932, there was filed in the office of the clerk of this court an answer to the petition for a rehearing, which said answer to the petition for a rehearing is not copied here.

46 In United States Circuit Court of Appeals

[Title omitted.]

Order denying rehearing

April 4, 1932

It is ordered by the court that the petition for a rehearing in this cause be, and the same is hereby, denied.

Memorandum re mandate

And afterwards, to wit, on the sixth day of April, 1932, the mandate of this court issued to the United States Board of Tax Appeals.

47 In United States Circuit Court of Appeals

[Title omitted.]

Motion for order staying mandate

Filed April 13, 1932

Now comes the respondent in the above-entitled cause, by Dwight H. Green, special attorney, Bureau of Internal Revenue, his attorney, and moves that the mandate of this court be stayed until further order of this court, and in support of this motion shows unto the court that the said respondent is considering the filing of a petition for certiorari with the Supreme Court of the United States.

DWIGHT H. GREEN,
Special Attorney, Bureau of Internal Revenue.

[File endorsement omitted.]

48 In United States Circuit Court of Appeals

[Title omitted.]

Order recalling and staying mandate

Filed April 13, 1932

On motion of counsel for respondent, it is now here ordered that the mandate of this court, heretofore issued in this cause, is hereby recalled.

It is further ordered that the said mandate be, and the same is hereby, stayed until the further order of this court, provided that counsel for respondent proceed with diligence and promptly file a petition for writ of certiorari in the Supreme Court of the United States, and upon the filing of said petition file in this court proof of the filing of said petition in said court.

49 [Clerk's certificate to foregoing transcript omitted in printing.]

50 Supreme Court of the United States

Order allowing certiorari

Filed October 10, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Indorsement on cover:) File No. 36889. U. S. Circuit Court of Appeals, Seventh Circuit, Term No. 192. David Burnet, Commissioner of Internal Revenue, petitioner, vs. Aluminum Goods Manufacturing Company. Petition for a writ of certiorari and exhibit thereto. Filed July 1, 1932. File No. 36889.

U. S. GOVERNMENT PRINTING OFFICE: 1932

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CHARLES ELMORE CROPLEY
Clerk

No. 192

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALUMINUM GOODS MANUFACTURING COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. ——

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

ALUMINUM GOODS MANUFACTURING COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit, entered on February 25, 1932, reversing the decision of the Board of Tax Appeals. (R. 39.) Petition for rehearing was denied April 4, 1932. (R. 41.)

STATEMENT

The facts found by the Board of Tax Appeals (R. 20–25) may be summarized as follows:

In 1914 respondent, a New Jersey corporation engaged in manufacturing, purchased all the capi-

tal stock of the Aluminum Sales and Manufacturing Company, a New York corporation, (hereinafter referred to as the Sales Company), for $29,749.80, and continued to hold the same during the period herein involved. Thereafter the Sales Company was principally engaged in selling goods manufactured by respondent and was primarily employed as an outlet for respondent's goods. The Sales Company made remittances to respondent from its collections and capital, for goods purchased, maintaining a revolving fund to meet operating expenses. This fund was replenished by recurrent advances from respondent. The business conducted by the Sales Company in Indianapolis was discontinued in 1916 and the New York place of business was discontinued in 1917. The business of the Sales Company during 1917 consisted chiefly of liquidating its assets and no business was transacted by it after that year. Certain assets were taken over by respondent and credited to its open account with the Sales Company. (R. 20–21.) At the close of 1917 the amounts owed by the Sales Company to respondent for advances and merchandise, totaled $47,486.31. Respondent charged off its books a portion of these advances on December 30, 1916, and the balance on December 31, 1917. These sums were not repaid. Respondent charged off on its books the $29,749.80 invested in the capital stock of the Sales Company, a portion on December 31, 1916, and the balance a year later.

So far as the record shows the process of liquidation was not completed before the close of the year 1917. The Sales Company was formally dissolved in February, 1918. (R. 22.)

Up to and including 1916 the respondent and the Sales Company made separate returns for tax purposes. The Sales Company sustained losses for 1914, 1915, and 1916. It sustained an operating loss in 1917 which was allowed by the Commissioner as a deduction in that year.

For the year 1917 respondent filed a separate return for normal tax purposes and a consolidated return with the Sales Company for excess-profits tax purposes. In the year 1917 respondent claimed and petitioner allowed a loss for normal tax purposes consisting of the total of advances to the Sales Company together with the purchase price of the stock, less the value of the equipment and good will received upon liquidation of the Sales Company. A loss was claimed for excess-profits tax purposes consisting of the same figure less the 1917 operating loss. (R. 23.) This the Commissioner disallowed. (R. 23–24.) The Board sustained the determination of the Commissioner. (R. 25–26.) Upon petition for review the Circuit Court of Appeals reversed and remanded the case to the Board of Tax Appeals, holding that the losses in question did not arise from intercompany transactions and were properly deductible from gross income upon the consolidated return for excess-profits tax purposes. (R. 39.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred—

1. In holding that losses sustained when the investment of respondent in the stock of the Sales Company became worthless, and losses arising from advances by the respondent to the Sales Company were deductible upon the consolidated excess-profits tax return of the affiliated corporations for 1917.

2. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in conflict with the decision of the Court of Claims in *Utica Knitting Co.* v. *United States,* 68 C. Cls. 77, certiorari denied, 281 U. S. 739. The court there held that no deduction could be claimed upon a consolidated excess-profits tax return for the year 1917 for losses arising from the stock investment of a parent corporation in a subsidiary and also for an unpaid balance due on open account between the two corporations, when the subsidiary was liquidated during the last month of the taxable year. The similarity in the facts of the *Utica* case and the present case is striking. The court below recognized that the decision in the *Utica* case was contrary to its decision and refused to follow it. (R. 25.)

2. The decision of the court below was erroneous. The court held in effect that the Treasury Regula-

tions, which have consistently required the elimination of intercompany transactions in computing the consolidated net income of affiliated corporations, did not apply to the losses involved in this case, or, if they did, that they were not authorized by the statute. These regulations, sustained by a number of decisions, clearly apply to respondent's losses. The court below also held that the losses sustained by the respondent were deductible, upon its 1917 consolidated return for excess-profits tax purposes upon the theory that liquidation of the Sales Company terminated the affiliation and the losses were therefore sustained after affiliation ended. In so far as the decision of the court below was based on the view that the statutes relating to affiliation apply only to corporations actively engaged in business, it is in conflict with *Autosales Corporation* v. *Commissioner,* 43 F. (2d) 931, 933 (C. C. A. 2d). The mere process of liquidation of the Sales Company did not terminate affiliation between that company and the respondent. Respondent continued to own the stock of the Sales Company after the taxable year and a consolidated return was filed for the entire taxable year 1917. Accordingly the statutory basis for affiliation continued throughout 1917.

3. The question whether in computing net income, intercompany transactions are to be disregarded under circumstances similar to those presented at bar, is one of general importance affecting substantial sums in taxes and a number of taxpayers. This

question is presented upon similar or analogous facts in numerous cases now pending in the Bureau of Internal Revenue, the Board of Tax Appeals, and the courts. The question arises under all the Revenue Acts since the Revenue Act of 1917.

Wherefore, it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

JULY, 1932.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–25) is reported in 22 B. T. A. 1. (See also supplemental memorandum opinion, R. 25–26.) The opinion of the Circuit Court of Appeals (R. 36) is reported in 56 F. (2d) 568.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 25, 1932. (R. 39.) Petition for rehearing was denied April 4, 1932. (R. 41.) The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the losses sustained by the respondent in 1917 upon its investment in the stock of the Sales Company and for indebtedness of the Sales Company to respondent were intercompany transactions which are to be disregarded for excess-profits tax purposes upon a consolidated return for 1917.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix (*infra*, pp. 15–18).

STATEMENT

A statement of the facts and the errors to be relied upon will be found in the petition.

ARGUMENT

The Revenue Act of 1917 originally made no provision for consolidated returns by affiliated corporations. Section 240 of the Revenue Act of 1918 provided expressly for consolidated returns by affiliated corporations and Section 1331 of the Revenue Act of 1921 (*infra*, p. 16) provided that for the purpose of determining excess-profits taxes Title II of the Revenue Act of 1917 "shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917."

The Treasury Regulations under the Revenue Act of 1918 and under subsequent Acts provide in substance that in determining the consolidated taxable net income of affiliated corporations intercompany transactions must be eliminated. (Article 637, Regulations 45; Article 636, Regulations 62; Article 636, Regulations 65; Article 635, Regulations 69; Article 734, Regulations 74; Articles 31, 38 (b), Regulations 75.) This consistent administrative interpretation of the Revenue Acts has implied legislative approval and is to be given the force of law. *Brewster* v. *Gage*, 280 U. S. 327. The principle that intercompany transactions are to be

eliminated in determining consolidated net income of affiliated corporations has also received repeated judicial approval. *Utica Knitting Co.* v. *United States,* 68 Ct. Cls. 77, certiorari denied, 281 U. S. 739; *Packard Motor Car Co.* v. *United States,* 39 F. (2d) 991, 997 (Ct. Cls.), certiorari denied, 282 U. S. 848; *Lavenstein Corporation* v. *Commissioner,* 25 F. (2d) 375 (C. C. A. 4th); *W. S. Bogle & Co.* v. *Commissioner,* 26 F. (2d) 771 (C. C. A. 7th); *Fidelity National Bank & T. Co.* v. *Commissioner,* 39 F. (2d) 58 (C. C. A. 8th).

While conceding that intercompany transactions, which resulted in gain to one and loss to the other of two affiliated corporations, should be eliminated, the court below held that the losses which respondent sought to deduct were not of that character but that if the Treasury Regulations requiring the elimination of intercompany transactions applied to respondent's losses, they were unauthorized. It is clear that the interpretation which the court below sought to place upon the Regulations was not justified, for the Regulations required the elimination of all intercompany transactions.

The loss sustained by respondent in the investment in stock of its subsidiary, as well as the loss sustained through the failure and inability of the subsidiary to pay its indebtedness to respondent, clearly arose out of intercompany transactions. In an almost precisely similar situation the Court of Claims in *Utica Knitting Co.* v. *United States, supra,* held that the loss arising out of investment

in stock of a subsidiary, and out of indebtedness due from the subsidiary to the parent corporation which it could not pay, constituted losses arising out of intercompany transactions which were to be eliminated in determining the income of affiliated corporations for excess-profits tax purposes. The decision of the court below is squarely in conflict with the decision in the *Utica Knitting Co.* case, *supra*, and the court below recognized that it was departing from the decision in that case.

The court below also held that liquidation of the Sales Company *ipso facto* terminated the affiliation of the two companies, apparently on the ground that the statute governing affiliated returns contemplated its application to active companies only. The decision upon this point is directly in conflict with the decisions in the *Utica Knitting Co.* case, *supra*, and *Autosales Corporation* v. *Commissioner*, 43 F. (2d) 931, 933 (C. C. A. 2d). There is nothing in the statutes or regulations which suggests that while the ownership or control upon which affiliation depends continues, it is necessary that all of the affiliated corporations should be actively engaged in business. *Autosales Corporation* v. *Commissioner, supra*, p. 933. In *Handy and Harman* v. *Burnet*, 284 U. S. 136, this Court said (p. 140):

> The purpose of §240 [of the Revenue Act of 1918] was, by means of consolidated returns, to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise, even though it was conducted by means of more than one corporation.

The fact that one branch of the enterprise is in course of liquidation does not end affiliation. The liquidation, in the present case, consisted merely in the transfer of the subsidiary's assets to the respondent. The respondent continued to hold the subsidiary's stock, which was neither sold nor surrendered up for cancellation. The parent company had merely drawn to itself the assets of its subsidiary and could have restored what it had taken away. The business enterprise was single as it had been since affiliation and the intercorporate transactions could not add to or subtract from the true income of the affiliated unit.

There are obvious practical difficulties attendant upon the view that liquidation terminates affiliation, which are indicated by the present record. Liquidation is a term of somewhat loose connotation. The present record does not show when liquidation occurred or was completed, with any degree of certainty. Dissolution, on the contrary, ends the corporate life of one of the affiliates. Affiliation ends then, for there ceases to be a corporation which can be a party to the affiilation. But short of that definitive event and in the absence of a disposition of ownership or control to outside interests, the status of affiliation continues.

The court below referred to a number of cases as supporting its conclusion, all of which are believed to be distinguishable.

In *Remington Rand, Inc.*, v. *Commissioner* (C. C. A. 2d), 33 F. (2d) 77, certiorari denied, 280 U. S.

591, the parent corporation sold the stock of its subsidiary to outside interests, thereby terminating the affiliation, and a *separate* return was filed for the ensuing period. The Board of Tax Appeals held that the transaction resulted in neither gain nor loss. The Circuit Court of Appeals reversed, observing that the sale terminated the affiliation, which resulted from the purchase of the stock; that both the purchase and sale took place outside the period of affiliation and were made by the seller for its own account, not for the account of the affiliated group. *Utica Knitting Co.* v. *United States, supra,* is in effect distinguished in the opinion in the *Remington Rand* case as follows (p. 78):

> *Whatever may be the rule where affiliation continues after the sale,* under the facts of the instant case we think the board erred in ruling that neither taxable gain nor deductible loss resulted to the parent company from the sale of the stock. (Italics ours.)

In *United Publishers' Corporation* v. *Anderson* (S. D. N. Y.), 42 F. (2d) 781, there was also a sale of the stock to outside interests, and the court, upon authority of *Remington Rand, Inc.,* v. *Commissioner, supra,* held that the resulting loss was deductible on a *separate* return for the ensuing period. *Riggs National Bank,* 17 B. T. A. 615, was affirmed 57 F. (2d) 980 (C. C. A. 4th). There a merger, equivalent to dissolution of the subsidiary, took place and the shares of the subsidiary stock owned by the parent corporation were surrendered

in exchange for assets. The loss was allowed as a deduction against *separate* income for a period subsequent to affiliation. In *Canal-Commercial National Bank,* 22 B. T. A. 541, there was an actual dissolution on the same day that the liquidation occurred. The gain realized was solely that of the parent company and one which was not reflected in the consolidated income of the affiliated corporations. (P. 550.) *American Printing Co.* v. *United States,* 53 F. (2d) 98 (D. Mass.), is likewise readily distinguishable. There the subsidiary ceased to do business on December 31, 1917, and was dissolved by decree of court "soon thereafter." (P. 98.) The taxable year was 1919, and affiliation had apparently ceased some time before the beginning of that year. The decision in *American Paper Exports* v. *Bowers,* 54 F. (2d) 508 (C. C. A. 2d), has no apparent bearing upon the question. In that case the court held merely that a single consolidated return should be filed for the entire year in case a parent corporation, organized during the course of the year, becomes affiliated with a subsidiary already in existence and active from the beginning of the year.

In *Wilmington Steamboat Co.* v. *Sturgess* (N. J.), 52 F. (2d) 210, affirmed, 55 F. (2d) 831 (C. C. A. 3d), the District Court indicated that if there was any loss to one of several affiliated corporations it could be deducted for excess profits tax purposes because affiliation ceased upon liquidation of one of the affiliates, but held as a matter

of fact that there was no loss. The Circuit Court of Appeals affirmed the determination on the question of fact and did not discuss the termination of affiliation.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous, and in view of the general importance of the question presented and the existence of a conflict of decisions, the petition for certiorari should be granted.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
SEWALL KEY,
WM. CUTLER THOMPSON,
Special Assistants to the Attorney General.

JULY, 1932.

APPENDIX

Revenue Act of 1916, approved September 8, 1916, c. 463, 39 Stat. 756, 767:

SEC. 12. (a) In the case of a corporation, * * * organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

* * * * *

Second. All losses actually sustained and charged off within the year * * *.

Revenue Act of 1917, c. 63, 40 Stat. 300, 305, 307:

TITLE II.—WAR EXCESS PROFITS TAX

SEC. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned * * * for the taxable year upon the same basis and in the same manner as provided in Title I of the Act * * * approved September eighth, nineteen hundred and sixteen, as amended by this Act, * * *.

SEC. 213. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make all necessary regulations for carrying out the provisions of this title, * * *

Revenue Act of 1921, approved November 23, 1921, c. 136, 42 Stat. 227, 309, 319:

CONSOLIDATED RETURNS FOR YEAR 1917

SEC. 1331. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

(b) For the purpose of this section a corporation or partnership was affiliated with one or more corporations or partnerships (1) when such corporation or partnership owned directly or controlled through closely affiliated interests or by a nominee or nominees all or substantially all the stock of the other or others, or (2) when substantially all the stock of two or more corporations or the business of two or more partnerships was owned by the same interests: *Provided,* That such corporations or partnerships were engagel in the same or a closely related business, or one corporation or partnership bought from or sold to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or one corporation or partnership in any way so arranged its financial relationships with another corporation or partnership as to assign to it a disproportionate share of net income or invested capital. * * *

(c) The provisions of this section are declaratory of the provisions of Title II of the Revenue Act of 1917.

SEC. 1303. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

* * * * *

Regulations 33 (Income Tax), promulgated under the Revenue Acts of 1916 and 1917:

> ART. 147. *When* [losses] *deductible.*—The deduction for losses must represent losses * * * which were charged off and actually sustained within the year as evidenced by closed and completed transactions.
>
> * * * * * *
>
> ART. 151. *Bad debts.*—Losses which may be properly deducted from gross income on account of bad debts or doubtful accounts are those losses which have been definitely ascertained to have occurred and which were charged off during the year for which the return is made. * *

Regulations 41 (War Excess Profits Tax), promulgated under the Revenue Act of 1917:

> ART. 77. *When affiliated corporations must furnish information as to intercorporate relations.*—For the purpose of the excess-profits tax every corporation will describe in its return all its intercorporate relationships with other corporations with which it is affiliated, and will furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting.
>
> For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and

both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital.

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No. 192

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALUMINUM GOODS MANUFACTURING COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 192

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

ALUMINUM GOODS MANUFACTURING COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 10–21) are reported in 22 B. T. A. 1. The opinion of the Circuit Court of Appeals (R. 25–28) is reported in 56 F. (2d) 568.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 25, 1932. (R. 29.) Rehearing was denied April 4, 1932. (R. 30.) Petition for a

writ of certiorari was filed July 1, 1932 (R. 31) and granted October 10, 1932 (R. 31). Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether upon liquidation of a subsidiary corporation having insufficient assets to meet its obligations, a parent corporation may deduct as losses the cost of stock in the subsidiary and the unrecovered balance of advances made by it to its subsidiary, in computing the consolidated net income of the two corporations subject to the excess-profits tax for 1917.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix. (*Infra*, pp. 20–29.)

STATEMENT

The facts as agreed upon by the parties and accepted by the Board of Tax Appeals (R. 10–15) may be summarized as follows:

In 1914 respondent, a New Jersey corporation engaged in manufacturing, purchased all the capital stock of the Aluminum Sales and Manufacturing Company, a New York corporation (hereinafter referred to as the Sales Company), for $29,749.80. Thereafter the Sales Company was principally engaged in selling goods manufactured by respondent and was primarily employed as an outlet for respondent's goods. The Sales Company made remittances to respondent from its collections and capital,

for goods purchased, maintaining a revolving fund to meet operating expenses. This fund was replenished by recurrent advances from respondent. The business conducted by the Sales Company in Indianapolis was discontinued in 1916, and the New York place of business was discontinued in 1917. The business of the Sales Company during 1917 consisted chiefly of liquidating its assets, and no business was transacted by it after that year. Certain assets were taken over by respondent and credited to its open account with the Sales Company. (R. 10–11.) At the close of 1917 the amounts owed by the Sales Company to respondent for advances and merchandise totaled $47,486.31. Respondent charged off its books a portion of these advances on December 30, 1916, and the balance on December 31, 1917. These sums were not repaid. Respondent charged off on its books the $29,749.80 invested in the capital stock of the Sales Company, a portion on December 31, 1916, and the balance a year later. (R. 11.) So far as the record shows the process of liquidation was not completed before the close of the year 1917. The Sales Company was dissolved in February, 1918. (R. 13–14.)

Up to and including 1916 the respondent and the Sales Company made separate returns for tax purposes. (R. 12.) The Sales Company sustained losses for 1914, 1915, and 1916. (R. 11.) It sustained an operating loss in 1917 which was allowed by the Commissioner as a deduction in that year. (R. 12.)

For the year 1917 respondent filed a separate return for normal tax purposes and a consolidated return with the Sales Company for excess-profits tax purposes. In the separate return for 1917 respondent claimed and petitioner allowed a loss for normal tax purposes consisting of the total of advances to the Sales Company together with the purchase price of the stock, less the value of the equipment and good will received upon liquidation of the Sales Company. A similar loss was claimed for excess-profits tax purposes, less the 1917 operating loss of the Sales Company. (R. 12.) This the Commissioner disallowed. (R. 12.) The Board sustained the determination of the Commissioner. (R. 21.) Upon petition for review the Circuit Court of Appeals reversed and remanded the case to the Board of Tax Appeals. (R. 29.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred—

1. In holding that when upon the liquidation of the Sales Company its stock became worthless and advances made to it by the respondent became uncollectible, the cost of the stock and the unpaid advances could be deducted as losses upon the consolidated excess-profits tax return of the affiliated corporations for 1917.

2. In reversing the judgment of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The loss claimed herein is not an allowable deduction in computing the *consolidated net income* of the

respondent and its subsidiary. War excess-profits taxes of affiliated corporations for the year 1917 were required to be computed upon the basis of consolidated returns of net income and invested capital. Respondent and its subsidiary were affiliated throughout the year 1917 and until the dissolution of the subsidiary in 1918. Mere liquidation of the assets of a subsidiary does not terminate affiliation.

The primary purpose of requiring consolidated returns was to levy taxes according to the true net income and invested capital resulting from and employed in a single business enterprise. To effectuate that purpose it is essential in computing the consolidated net income for affiliated corporations that all intercompany transactions, whether resulting in gain or loss, be eliminated. The losses in question occurred in intercompany transactions. Hence such losses, although allowed as deductions to the respondent in computing its separate net income for the normal tax, may not be allowed as a deduction in computing the consolidated net income of the respondent and the Sales Company for excess profits tax purposes. To permit the deduction of such losses on a consolidated return of net income would amount to carrying forward all the operating losses of the subsidiary for prior years and in effect would be to levy the profits tax on the basis of the respondent's separate net income but at rates measured by the consolidated invested capital, for which there is no authority in law.

Even if it should be held that affiliation in this case was terminated upon liquidation, nevertheless the decision of the Board of Tax Appeals was correct. The court below held that the loss was suffered upon termination of affiliation, which occurred, so it was held, when the Sales Company was liquidated in 1917. Under this ruling there could be no change in the amount of the consolidated excess-profits liability as determined by the Commissioner and sustained by the Board, because it was stipulated that the Sales Company was liquidated on December 31, 1917, and accordingly there was no income received after affiliation against which such loss might be offset. Hence, a recomputation of respondent's tax liability for 1917, even in accordance with the conclusions of the court below, would result in the same deficiency as that set forth in the decision of the Board of Tax Appeals.

ARGUMENT

The Revenue Act of 1917 under Title II imposed a war excess-profits tax (in addition to the normal income tax) upon the income of corporations, at varying percentages of the net income in excess of specified amounts. The statute originally made no provision for consolidated returns of income by affiliated corporations, but the Treasury Regulations adopted pursuant to the Act did provide that the excess-profits tax of affiliated corporations should be computed upon the basis of consolidated returns of net income and invested capital. Regulations 41,

Articles 77, 78. The Revenue Act of 1918, Section 240, c. 18, 40 Stat. 1057, 1081, expressly provided for consolidated returns by affiliated corporations, and the Revenue Act of 1921, Section 1331, *infra*, p. 27, provided that for the purpose of determining excess-profits taxes the Revenue Act of 1917

> shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

The manifest purpose of requiring consolidated returns by affiliated corporations was to impose the war taxes according to the true net income and invested capital of what was a single business enterprise, even though conducted by means of more than one corporation. See *Handy & Harman* v. *Burnet*, 284 U. S. 136, 140; *Gould Coupler Co.*, 5 B. T. A. 499, 516. This purpose could be effectuated only by treating affiliated corporations as a unit and by eliminating in the computation of the net income and invested capital of the group all duplications in capital and all intercompany transactions. These fundamental principles find expression in the Treasury Regulations under the Revenue Act of 1918 and subsequent Acts. See Regulations 45, Art. 637; Regulations 62 and Regulations 65, Art. 636; Regulations 69,

Art. 635; Regulations 74, Art. 734; Regulations 75, Articles 31 and 38(b). This consistent administrative interpretation of the Revenue Acts has implied legislative approval and should be given the force and effect of law. *Brewster* v. *Gage*, 280 U. S. 327, 336–337.

In the instant case it is apparently unquestioned that respondent and the Sales Company were affiliated corporations throughout the year 1917 and hence were required to make a consolidated return of net income for the excess-profits tax, as provided in the statute and regulations. The Sales Company continued in existence throughout that year and all its stock was then owned by the respondent, although it was engaged principally in closing out its business and by the end of the year had completed liquidation by transferring its remaining assets to its parent, the respondent. The stock of the Sales Company had been purchased for cash by the respondent from outside interests in 1914, and from that time until liquidation the respondent advanced to the Sales Company such sums as were required for operation. Upon the liquidation of the Sales Company there remained no assets from which the respondent could recover the cost of the stock or reimburse itself for unpaid advances. These two items aggregated $66,551.55. The Commissioner allowed the respondent a deduction of that sum as a loss in computing its separate

net income for 1917 normal tax.[1] The respondent claimed that the loss of stock investment and advances made by it to its subsidiary, less the 1917 operating loss of the Sales Company which was allowed by the Commissioner, or the net amount of $51,861.90, was an allowable deduction in computing the consolidated net income for 1917 subject to the excess-profits tax. The Commissioner disallowed the claimed deduction.

The court below, despite the statutes and administrative practice discussed above, held that the deduction was properly claimed and should have been allowed. In so holding it concluded that affiliation between respondent and the Sales Company was terminated by the latter company's liquidation and that, therefore, the losses involved in the present claim occurred outside the period of the affiliation of the two companies. It concluded further that, even were the case otherwise, neither the loss sustained by respondent in its purchase of the stock of the Sales Company nor the loss sustained through its loans and advances to the Sales Company were suffered in intercompany transactions. The order of the Board of Tax Appeals upholding the Commissioner was therefore reversed.

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[1] It should be noted that for the year 1917 only the war excess-profits tax of affiliated corporations was to be computed upon the basis of consolidated returns of net income and invested capital. The normal income tax of affiliated corporations was to be computed upon the basis of their separate net income.

For the purpose of this case it is assumed that the stock and the debt became valueless upon liquidation.

I

AFFILIATION OF THE RESPONDENT AND THE SALES COMPANY WAS NOT TERMINATED BY THE LIQUIDATION OF THE LATTER IN 1917. TRANSFERS OF PROPERTY BETWEEN THE RESPONDENT AND ITS SUBSIDIARY WERE THEREFORE INTERCOMPANY TRANSACTIONS WITHIN THE AFFILIATED GROUP, WHICH MUST BE DISREGARDED IN THE COMPUTATION OF CONSOLIDATED NET INCOME

The court below was of the opinion that the mere liquidation of the Sales Company terminated the affiliation between it and the respondent. This conclusion is unsound and apparently rests upon the erroneous assumption that only active corporations may be affiliated. Treasury Regulations 41, promulgated under the Revenue Act of 1917, Art. 77 (*infra* p. 29), provided that, for purposes of returns under the war excess profits tax, "* * * two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly * * * all or substantially all of the stock of the other or others * * *." The Revenue Act of 1921, Sec. 1331 (*infra*, p. 27), gave legislative sanction to the administrative requirement that affiliated corporations file consolidated returns for excess profits tax purposes, and provided that, under the Revenue Act of 1917, a corporation was to be deemed affiliated with one or more other corporations "(1) when such corporation * * * owned directly * * * all or substantially all the stock of the other or others." There is nothing in the statutes or regulations which suggests that, so long as the ownership or control upon which affiliation depends continues, it is neces-

sary that all of the affiliated corporations should be actively engaged in business. The wording of the statute is plain; it clearly states that ownership by one corporation of the stock of another shall be the test of affiliation. In the instant case, although the Sales Company transferred its assets to the respondent at the close of 1917 its stock was still outstanding and owned by the respondent, and the existence of the two corporations as separate but affiliated corporations continued. In *Autosales Corporation* v. *Commissioner*, 43 F. (2d) 931, 933 (C. C. A. 2d), it is pointed out that the mere inactivity of the subsidiary is immaterial and indeed presents the very situation in which the economic unity of the two corporations contemplated by the affiliation provisions of the statute is most apparent.

In *Utica Knitting Co.* v. *United States*, 68 C. Cls. 77, certiorari denied, 281 U. S. 739, the Court of Claims upon closely similar facts held that the liquidation of the subsidiary did not terminate the affiliation within the taxable year, and that the loss of the stock investment and loans, thereby sustained by the parent corporation, were sustained in an intercompany transaction and were not allowable deductions in computing consolidated net income of 1917 for profits-tax purposes. The court said (pp. 87–88):

> We can not agree with the contention of plaintiff that the fact that the subsidiary company in 1917 manufactured no products, incurred no expenses or liabilities, that its sole activities were to collect certain accounts

and to pay certain debts, to wind up its affairs, and to turn over to plaintiff all its property, in any way relieves plaintiff and its subsidiary from the provisions of section 1331, above quoted. The relations between plaintiff and the Unitee Knitwear Company continued, and they were a unit until the latter company was finally liquidated in December, 1917.

It would be an extremely technical evasion of the purpose of the statute to hold that a conceded affiliation ceases when the subsidiary ceases to sell and manufacture goods, while at the same time the parent company owns all the stock of the subsidiary, and the subsidiary continues in business for the purpose of winding up its affairs, turning over its property to the parent, collecting its accounts, and paying its debts, which very debts and accounts arose out of the knitwear business in which both the parent company and the subsidiary were engaged.

The commissioner was correct in refusing to consider the intercompany transactions between plaintiff and its subsidiary, with reference to the excess-profits tax. The very purpose of section 1331 of the revenue act of 1921, *supra*, was to treat affiliated corporations as an entity, or a business unit, and to eliminate intercompany transactions.

The liquidation of a subsidiary corporation and the transfer of its assets to the parent corporation has long been treated by the Bureau of Internal Revenue as an intercompany transaction, and any gain or loss n respect of the stock investment or loans by the

parent resulting from such a liquidation has been consistently disregarded in computing the consolidated net income of the affiliated corporations. Sol. Op. 131, C. B. I–1, p. 18; G. C. M. 1501, C. B. VI–1, p. 260; G. C. M. 2774, C. B. VII–1, p. 196. This Bureau practice ultimately found expression in Treasury Regulations 75, Art. 37, and is entitled to consideration and weight. See *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.

The practical reason for this administrative practice is clear. As shown above, the primary purpose of the provisions for consolidated returns is to reflect accurately the true financial condition of a business enterprise by disregarding the corporate units which compose the whole. The liquidation of a subsidiary does not affect the group holdings differently from a sale within the group. In the present case, when the Sales Company liquidated, the income or assets of the group composed of itself and petitioner were neither increased nor decreased. A consolidated balance sheet constructed after the liquidation would show the same net worth as before, and, for tax purposes, the transaction is the same as the discontinuance of a branch or department of a single corporation. Not only is this true of the stock of the subsidiary, but it is equally applicable to the loss of the alleged bad debt consisting of advances made by the parent. The writing off the amount of the open account between petitioner and the Sales Company resulted in neither gain nor loss to the affiliated group.

The cases referred to by the court below as supporting its conclusion that the affiliation was terminated by the liquidation, and hence that the losses were sustained outside the period of affiliation, may be distinguished.

In *Remington-Rand, Inc.* v. *Commissioner*, 33 F. (2d) 77 (C. C. A. 2d), certiorari denied, 280 U. S. 591, the parent corporation sold the stock of its subsidiary to outside interests and thus terminated the affiliation; a *separate* return was filed for the period between the time of such termination and the end of the taxable year involved. The Board of Tax Appeals held that the transaction resulted in neither gain nor loss. The Circuit Court of Appeals reversed on the ground that the sale terminated the affiliation which resulted from the original purchase of the stock of the subsidiary; both the purchase and sale, it was held, took place outside the period of affiliation and were for the parent corporation's own account, not for the account of the affiliated group. *Utica Knitting Co.* v. *United States, supra,* is in effect distinguished in the opinion in the *Remington-Rand case* (p. 78):

> *Whatever may be the rule where affiliation continues after the sale,* under the facts of the instant case we think the board erred in ruling that neither taxable gain nor deductible loss resulted to the parent company from the sale of the stock. (Italics ours.)

The fact that certiorari was denied in both the *Utica Knitting Co.* and the *Remington-Rand cases* is persuasive that the decisions are not in conflict.

In *United Publishers' Corporation* v. *Anderson*, 42 F. (2d) 781 (S. D. N. Y.), there was also a sale of the stock to outside interests, and the court, upon authority of the *Remington-Rand case*, held that the resulting loss was deductible on a *separate* return for the ensuing period. In *Burnet* v. *Riggs National Bank*, 57 F. (2d) 980 (C. C. A. 4th), a merger equivalent to dissolution of the subsidiary took place and the shares of the subsidiary stock owned by the parent corporation were surrendered in exchange for assets. Here again the loss was allowed as a deduction against *separate* income for a period subsequent to affiliation. In *Canal Commercial National Bank*, 22 B. T. A. 541, there was an actual dissolution on the same day that the liquidation occurred. The gain realized was solely that of the parent company and was not reflected in the consolidated income of the affiliated corporations (p. 550).

In *American Printing Co.* v. *United States*, 53 F. (2d) 98 (D. Mass.), the subsidiary ceased to do business on December 31, 1917, and was dissolved by decree of court "soon thereafter" (p. 98). The taxable year was 1919 and affiliation had apparently ceased some time before the beginning of that year. The case involved a depreciation allowance with respect to the property acquired by the parent upon the liquidation of its subsidiary. The court remarked, however, that "it is agreed that the petitioner and the Iron Works were affiliated for excess-profits tax pur-

poses during the year 1917 * * *." The decision in *American Paper Exports* v. *Bowers*, 54 F. (2d) 508 (C. C. A. 2d), has no apparent bearing upon the question. In that case the court held merely that a single consolidated return should be filed for the entire year, in case a parent corporation organized during the course of the year becomes affiliated with a subsidiary already in existence and active from the beginning of the year.

Wilmington Steamboat Co. v. *Sturgess*, 52 F. (2d) 210 (N. J.), affirmed 55 F. (2d) 831 (C. C. A. 3d), is more nearly similar to the instant case on its facts. There the District Court indicated that if there was any loss to one of several affiliated corporations it could be deducted for excess-profits tax purposes because affiliation ceased upon liquidation of one of the affiliates. But the court held that on the facts there had been no loss and consequently its observations upon the question of affiliation lose much of their force. The Circuit Court of Appeals affirmed the determination on the question of fact and did not discuss the problem of affiliation adverted to by the lower court.

An entirely different situation is involved where all the stock of a subsidiary is sold to persons not identified with the affiliated group. Such a sale terminates all interest of the parent corporation in the subsidiary and its property. Any gain or loss thus established does not result from a transaction between the parent

and the subsidiary, and it should be recognized in determining the separate net income of the parent. In the present case, on the other hand, the parent merely took over the assets of the subsidiary, retaining, as before, its control through stock ownership. The apparent gain or loss in such circumstances results solely from a shifting of properties and accounts between members of the same affiliated group, which does not affect the financial situation of the enterprise viewed as a whole. In the case of a final dissolution, the surrender of the stock and the dissolution of the subsidiary have the same definitive qualities as a sale. In that case the subsidiary is extinguished; the parent corporation thereafter retains no interest in the subsidiary, any loss of investment or loans by the parent corporation, theretofore only potential, may be considered as fixed and determined. In the instant case the Sales Company was not dissolved until February, 1918.[2] Until that event there was no dissolution or surrender of the stock but merely a transfer of assets, and it could not be known what loss, if any (other than a loss on an intercompany trans-

[2] Although the petitioner in the court below conceded *arguendo* that the losses in question were sustained if at all in 1917, the principle contended for was that ostensible losses suffered by one of a group of affiliated corporations in an intercompany transaction during the period of affiliation are not allowable deductions upon the consolidated return by the group. In support of that principle here the petitioner feels justified in pointing out that such losses are not actually sustained by mere liquidation without dissolution.

action), the respondent would actually sustain upon its investment and loans.[3]

II

ANY LOSSES SUSTAINED BY THE RESPONDENT IN CONNECTION WITH TAKING OVER THE ASSETS OF ITS WHOLLY OWNED SUBSIDIARY UPON THE LATTER'S LIQUIDATION WERE STRICTLY INTERCOMPANY AND HENCE NOT ALLOWABLE DEDUCTIONS IN COMPUTING THE CONSOLIDATED NET INCOME OF THE RESPONDENT AND ITS SUBSIDIARY FOR 1917

The courts have repeatedly recognized as fundamental the principle that intercompany transactions must be eliminated in computing the consolidated net income of affiliated corporations. See *Utica Knitting Co.* v. *United States*, *supra*; *Packard Motor Car Co.* v. *United States*, 39 F. (2d) 991, 997 (C. Cls.), certiorari denied, 282 U. S. 848; *Lavenstein Corporation* v. *Commissioner*, 25 F. (2d) 375, 376 (C. C. A.

[3] The fact that the Commissioner allowed respondent a deduction for the losses in 1917 for normal tax purposes does not indicate that the position here urged is untenable. For normal tax purposes the respondent and the Sales Company were separate and independent entities, while for excess-profits tax purposes they were a single business enterprise. For the normal tax the income of each determined separately was the subject of tax; but for the excess-profits tax it was the consolidated income of both as a unit that was to be determined. In one case the fact of loss is controlling; in the other, the continuance of corporate existence and hence of affiliation. It does not follow that a loss has been sustained by a member corporation of an affiliated group because the loss was sustained in respect of the same subject matter by the corporation as an independent taxable entity. In any event, if the Commissioner's allowance of the deduction in 1917 upon the returns for normal tax purposes was erroneous, the respondent, of course, can not complain of an error by which it has benefited.

4th); *Fidelity National Bank & Trust Co.* v. *Commissioner*, 39 F. (2d) 58 (C. C. A. 8th).

The court below, while not expressly repudiating this accepted rule, held that transactions like those now involved were not intercompany in their nature, and that the departmental practice and regulations, if they purported to define them as intercompany, were not in accordance with the statute and hence could not be enforced.

We submit that the transactions resulting in the losses here in question were strictly intercompany. These losses occurred in dealings exclusively between the respondent and its wholly owned subsidiary, the Sales Company. The Circuit Court of Appeals took the contrary view, because the stock was not purchased directly from the Sales Company and because the Sales Company's inability to repay the advances arose from losses suffered in its dealings with third persons. But these facts are immaterial, for it was not the purchase of the stock or the previous unprofitable operations of the Sales Company which were the sources of the losses now claimed. The respondent actually suffered no loss either when it bought the stock or made the advances, or when the Sales Company sustained losses in the conduct of its business. The respondent's losses on account of its unpaid advances were suffered only when respondent having received all the assets of the Sales Company in partial satisfaction of its advances, it was evident that no more would be paid. The advances to the Sales Company and the partial repay-

ment to the parent were wholly and strictly intercompany transactions. It does not matter why the Sales Company could not respond in full.

While it is true that the stock was not purchased directly from the Sales Company, the price which was paid for it was an investment in its capital. The purchase of the shares created the intercompany relationship, and the losses resulting from their depreciation were incurred, if incurred prior to dissolution, in a transaction essentially intercorporate, namely, the investment by one corporation in the capital of its subsidiary. Furthermore, it was only by the transfer of remaining assets from one company to the other that the measure of the worthlessness of the stock was established. Had the shares been sold at a loss to an outsider, affiliation would have been ended and the sale would not have been an intercompany transaction, but that was not the case. Here the loss was necessarily an intercompany loss, since it represented merely the depreciation in the value of the respondent's interest in the assets of the Sales Company. Cf. *Fidelity National Bank & Trust Co.* v. *Commissioner, supra; Golden Cycle Corporation* v. *Commissioner*, 51 F. (2d) 927 (C. C. A. 10th).

Manifestly, if intercompany debts and losses incurred by the parent company through the exhaustion of capital reflected in the value of a subsidiary's stock which the parent continues to own and control, are not to be treated as intercompany transactions, there can be no true consolidated return of

the income of the affiliated group. The mandate of the Regulations could not be obeyed by treating the corporations as affiliated in computing their joint income, but as separate entities where their losses were involved. Nor could necessary computations of invested capital be made if affiliation is overlooked. It is only by this process that the losses in question could be recognized in 1917 while affiliation continued.

Until a definitive event, such as a sale to outside interests or a dissolution, any transfers of property between the respondent and its subsidiary were internal transactions within the affiliated business group. Although the *respondent's* potential loss on account of its investment in and advances to its subsidiary appeared certain in 1917, it was not a loss to the *business unit* consisting of the Sales Company and itself incurred in 1917. The losses actually incurred by the Sales Company in its operations during 1917 were allowed as deductions by the petitioner. This loss and losses of prior years were reflected in the depreciation of its stock and the exhaustion of its assets which rendered its debts uncollectible. Since there was no disposition of the stock nor any dissolution of the subsidiary in 1917, affiliation continued. The fact that this situation might have been easily avoided is not material. The tax laws are replete with instances where apparently formal action would alter the results reached, but the presence of some loopholes in the taxing statutes does not warrant judicial expansion of their number. See *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 330. Tax liabilities

must be determined by what was in fact done and not by what might have been done.

If, as the Circuit Court of Appeals holds, the losses in question may be deducted upon the consolidated return of the respondent and the Sales Company, it results that the excess-profits tax is to be computed upon the basis of the *separate* net income of the respondent but at rates determined by the use of the *consolidated* invested capital of both corporations. Such a result finds no sanction in law and contravenes the requirement of the statute that the excess-profits tax be determined on the basis of consolidated net income *and* invested capital. Further, the respondent in effect seeks to carry forward to the year 1917 all the operating losses of the Sales Company in prior years and deduct the same from income in 1917, for which there is no authority in the statute. To allow such losses is to permit the respondent indirectly to apply against its income, in computing 1917 consolidated net income, losses sustained by the Sales Company and properly allowable to it in prior years. This Court has said that such a result may not be accomplished directly (*Woolford Realty Co.* v. *Rose*, 286 U. S. 319; *Planters Cotton Oil Co.* v. *Hopkins*, 286 U. S. 332), and it should not be permitted indirectly.

If the decision below be sound it would seem that the purpose of the Revenue Acts to ignore apparent gains and losses arising from transactions between affiliated corporations will be frustrated. It permits mere transfers of assets among affiliated corporations to give rise to gains and losses, appropriate enough

when individual taxpayers are concerned, but only apparent and not real where taxes are laid on a single business enterprise in which transactions between its parts are disregarded.

III

EVEN UNDER THE HOLDING OF THE COURT BELOW A RECOMPUTATION OF RESPONDENT'S TAX LIABILITY FOR 1917 WOULD RESULT IN THE SAME DEFICIENCY AS THAT DECIDED UPON BY THE BOARD OF TAX APPEALS

Even should respondent's contention that affiliation in this case was terminated by liquidation be deemed legally correct, which we deny, we believe that the decision of the Board of Tax Appeals should have been affirmed by the court below. The stipulated facts show that the liquidation of the subsidiary was consummated December 31, 1917. There is nothing in the record to indicate that such liquidation occurred prior to the last moment of that day, and indeed respondent's own conduct at the time indicates that it did not regard affiliation as having ceased at any time during the year. Had affiliation ceased during the year, a computation of the excess-profits tax upon the basis of respondent's separate income for the remaining portion of the year would have been proper (see *Remington-Rand, Inc.*, v. *Commissioner*, *supra*; *Sweets Co. of America* v. *Commissioner*, 40 F. (2d) 436 (C. C. A. 2d); cf. *American Paper Exports, Inc.*, v. *Bowers*, *supra*); but no return for that portion of the year was filed and no effort to file one was ever made, so far as the record discloses. See *Ludlow Valve Manufacturing Co.* v. *Durey*, 57 F. (2d) 583 (N. D. N. Y.).

The respondent's contention was that the losses in question were deductible in computing the consolidated net income of the affiliated companies.[4] This we have shown was not permissible. But whether our contention is sound or not, the facts of this case disclose that affiliation terminated, if at all, coincidently with the end of the tax year. (R. 11.) Even if, for the sake of the argument, the conclusion of the court below that the loss occurred outside the period of affiliation—that is, upon liquidation—be accepted, the respondent's excess profits tax was nevertheless correctly determined by the Commissioner and sustained by the Board, because so far as appears no income was received by the respondent in 1917, after affiliation terminated, against which such loss might have been offset.[5]

---

[4] Before the Board of Tax Appeals it was not contended by the respondent that the statutory affiliation ceased prior to the year 1918. (R. 20.) Although the Circuit Court of Appeals concluded that the losses in question were suffered in 1917, and outside the period of affiliation, the respondent's claim before the Bureau of Internal Revenue was that these losses, less the operating loss of the Sales Company in 1917, should be allowed in connection with the audit of its consolidated return (R. 5, 19), and the disallowance of this claim was the basis of its petition for a redetermination of the resulting deficiency by the Board of Tax Appeals (R. 5).

[5] The taxpayer had the burden of proving that the net income of the affiliated group prior to the termination of the affiliation, if it occurred by the liquidation of the Sales Company, as held by the court below, was less than the amount of $1,600,363.52, as determined by the Commissioner. See *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357, 361; *Reinecke* v. *Spalding*, 280 U. S. 227, 232–233.

This anomalous situation was not present in *Remington-Rand, Inc.*, v. *Commissioner, supra*, where affiliation was terminated February 28, 1920, and the profit was taxed during the last ten months of 1920, nor in *Burnet* v. *Riggs National Bank, supra*, where it was held that affiliation terminated June 10, 1922, and the loss was allowed as against separate income for the remainder of that year.

For these reasons a recomputation of the income and profits tax liability of the respondent for the year 1917, even in accordance with the conclusions of the court below, would result in the same deficiency as that set forth in the decision of the Board of Tax Appeals from which respondent appealed to the Circuit Court of Appeals. The decision of the Board, even though based upon reasoning deemed by the court below to be erroneous, was nevertheless the same that should be rendered on the basis of the conclusions of the Circuit Court of Appeals. We do not acknowledge the correctness of those conclusions, but we submit that, even should their validity be accepted, the court below should have affirmed the decision of the Board of Tax Appeals. The Circuit Courts of Appeals have power to reverse only "if the decision of the Board is not in accordance with law." Section 1003 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 110 (U. S. C. Title 26, Sec. 1226). See *Houston* v. *Commissioner*, 53 F. (2d) 445 (C. C. A. 3d); *Thom* v. *Burnet*, 55 F. (2d) 1039 (App. D. C.). In this sense the word "decision" means the Board's order specifying the amount of the deficiency. Reve-

nue Act of 1928, Sec. 601, c. 852, 45 Stat. 791, 871–872 (amending Revenue Act of 1924, Sec. 906; U. S. C. Sup. V, Title 26, Sec. 1217).

CONCLUSION

The decision below should be reversed and that of the Board of Tax Appeals affirmed.

Respectfully submitted.

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NOVEMBER, 1932.

APPENDIX

Revenue Act of 1916, approved September 8, 1916, c. 463, 39 Stat. 756, 767:

> SEC. 12. (a) In the case of a corporation, * * * organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> * * * * *
>
> Second. All losses actually sustained and charged off within the year * * *.

Revenue Act of 1917, c. 63, 40 Stat. 300, 305, 307:

> TITLE II.—WAR EXCESS PROFITS TAX
>
> SEC. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned * * * for the taxable year upon the same basis and in the same manner as provided in Title I of the Act * * * approved September eighth, nineteen hundred and sixteen, as amended by this Act, * * *.
>
> SEC. 213. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make all necessary regulations for carrying out the provisions of this title, * * *

Revenue Act of 1921, approved November 23, 1921, c. 136, 42 Stat. 227, 309, 319:

> CONSOLIDATED RETURNS FOR YEAR 1917
>
> SEC. 1331. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corpora-

tions and domestic partnerships that were affiliated during the calendar year 1917.

(b) For the purpose of this section a corporation or partnership was affiliated with one or more corporations or partnerships (1) when such corporation or partnership owned directly or controlled through closely affiliated interests or by a nominee or nominees all or substantially all the stock of the other or others, or (2) when substantially all the stock of two or more corporations or the business of two or more partnerships was owned by the same interests: *Provided*, That such corporations or partnerships were engaged in the same or a closely related business, or one corporation or partnership bought from or sold to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or one corporation or partnership in any way so arranged its financial relationships with another corporation or partnership as to assign to it a disproportionate share of net income or invested capital. * * *

(*c*) The provisions of this section are declaratory of the provisions of Title II of the Revenue Act of 1917.

SEC. 1303. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

* * * * *

Regulations 33 (Income Tax), promulgated under the Revenue Acts of 1916 and 1917:

ART. 147. *When (losses) deductible.*—The deduction for losses must represent losses * * * which were charged off and actually sustained within the year as evidenced by closed and completed transactions.

* * * * *

ART. 151. *Bad debts.*—Losses which may be properly deducted from gross income on account of bad debts or doubtful accounts are those losses which have been definitely ascertained to have occurred and which were charged off during the year for which the return is made. * * *

Regulations 41 (War Excess Profits Tax), promulgated under the Revenue Act of 1917:

ART. 77. *When affiliated corporations must furnish information as to intercorporate relations.*—For the purpose of the excess-profits tax every corporation will describe in its return all its intercorporate relationships with other corporations with which it is affiliated, and will furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting.

For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationships with another corporation as to assign it a disproportionate share of net income or invested capital.

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No. 192

In the Supreme Court of the United States

October Term, 1932.

DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

ALUMINUM GOODS MANUFACTURING COMPANY,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
J. GILBERT HARDGROVE,
Counsel for Respondent.

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No. 192

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October Term, 1932.

DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

ALUMINUM GOODS MANUFACTURING COMPANY,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

OBJECTIONS TO GRANTING OF WRIT.

Respondent opposes the granting of a writ of certiorari upon the following grounds:

1. The decision of the Circuit Court is consistent with decisions in other courts and has already been accepted as authoritative in other cases.

Consistent with the decision in this case, are the following cases which preceded it:

Remington Rand, Inc. vs. Commissioner, 33 F. (2d) 77 (C. C. A. 2) certiorari denied 280 U. S. 591.

United Publishers' Corporation vs. Anderson, 42 F. (2d) 781 (S. D. N. Y.).

Wilmington Steamboat Company vs. Sturgess, 52 F. (2d) 210 (D. C. N. J.) affirmed 55 F. (2d) 831 (C. C. A. 3).

American Printing Company vs. United States, 53 F. (2d) 98 (D. C. Mass.).

Since the decision in the instant case was made, it has been followed and cited with approval by the Circuit Court of Appeals for the Fourth Circuit in *Burnet vs. Riggs National Bank,* 57 F. (2d) 980 (C. C. A. 4), and also by the United States Board of Tax Appeals in *Houghton & Dutton Co. vs. Commissioner,* 26 B. T. A. 52, and in *Emerson Carey Fibre Products Co. et al vs. Commissioner,* 26 B. T. A. ..... (July 19, 1932, Dockets 36381, 36382).

The only decision which petitioner claims is substantially in conflict is that of the Court of Claims in *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77 (certiorari denied 281 U. S. 739), which decision has been distinguished on similar facts in *H. Liebes & Company vs. Commissioner,* 23 B. T. A. 787.

2. The issues arise under a statute long since repealed. They are not of general importance and involve no great principle.

The petitioner or his predecessors in office have continually sought to deny losses, as here, and inconsistently to tax gains arising from liquidation or the sale of the stock

of an affiliated corporation but the courts have uniformly adopted the principle which is accepted by the court below and have allowed the deduction of losses and permitted the taxation of gains.

The instant case, relating to taxable income for the year 1917, has been in continuous litigation for over ten years, despite the efforts of the respondent to prevent delay.

3. The decision of the Circuit Court of Appeals is correct and recognizes substance as well as form.

The petitioner's position seeks a narrow refinement, and that not of the statutes, but of the departmental regulations which refinement the court below refused to accept.

ARGUMENT.

I.

The Decision of the Circuit Court is Consistent with Decisions in Other Courts and has Already been Accepted as Authoritative in other Cases.

A.

The decisions claimed to be contrary to the case at bar have been distinguished.

The principal reason advanced by the petitioner for granting the writ is that the decision of the court below is in conflict with the decision of the Court of Claims in *Utica Knitting Company vs. U. S.*, 68 Ct. Cls. 77 (certiorari denied 281 U. S. 739), and that to a limited extent it is in conflict with *Auto Sales Corporation vs. Commissioner*, 43 F. (2d) 931 (933) (C. C. A. 2). The court below in its opinion cites six cases from other courts (including the Circuit Court of Appeals for the Second Circuit, three separate United States District Courts and the United States Board of Tax Appeals) and these cases are discussed in the brief of the petitioner in an attempt to distinguish them from the instant case, despite the fact that these alleged distinguishing points were fully presented to the court below and that the court found the cases undistinguishable. These six harmonious cases and others will be discussed hereinafter.

If the decision of the Court of Claims in *Utica Knitting Company vs. U. S.*, 68 Ct. Cls. 77 (certiorari denied 281 U. S. 739), were in conflict with the instant case, it would not be ground for granting the writ as prayed, in view of the harmony to be found in all other decisions. However, this decision of the Court of Claims has been distinguished on

the facts from a very similar case, decided by the Board of Tax Appeals after its decision in the instant case and while the instant case was pending in the court below. *(H. Liebes & Company vs. Commissioner,* 23 B. T. A. 787). The petitioner's position seems to be that despite the fact that all business of the subsidiary ceased and all business relations between the subsidiary and parent corporation were terminated at the final liquidation of the subsidiary on December 31, 1917, the fact that there was an interval of several weeks prior to formal dissolution of the subsidiary is sufficient to distinguish it from all other cases and to put this case and that of *Utica Knitting Company vs. U. S.* 68 Ct. Cls. 77 (certiorari denied 281 U. S. 739), in a class by themselves and in conflict. Petitioner is incorrect in this assertion, for several of the consistent cases cited by the court below and hereinafter discussed had the same pertinent facts. The case of *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77 (certiorari denied 281 U. S. 739), was discussed by the Board of Tax Appeals in *H. Liebes & Company vs. Commissioner,* 23 B. T. A. 787, as follows:

[23 B. T. A. 791] "* * * In the *Utica Knitting Co.* case the court said:

> It would be an extremely technical evasion of the purpose of the statute [requiring consolidated returns] to hold that a conceded affiliation ceases when the subsidiary ceases to sell and manufacture goods, while at the same time the parent company owns all the stock of the subsidiary, and the subsidiary continues in business for the purpose of winding up its affairs, turning over its property to the parent, collecting its accounts and paying its debts, which very debts and accounts arose out of the knitwear busi-

ness in which both the parent company and the subsidiary were engaged.

It is clear from this quotation that the two cases are different. Here the subsidiary corporation had completely gone out of business before the end of the year and it had no property to turn over to the parent company.

While it may be that at the end of 1921 petitioner and the Ganss Fur Company were technically affiliated because petitioner still owned the stock, *a denial of a loss claim on account of that technicality would be to ignore the substance of the situation.* Had the petitioner sold the stock in 1921 for a nominal sum —which was all that could have been realized—the case would clearly come within the case *Remington Rand, Inc. vs. Commissioner,* 33 Fed. (2d) 77. The fact that petitioner failed to go out of its way to attempt to make a sale, when in all probability a bona fide sale could not have been effected, should not affect the result. In our opinion loss resulting from worthlessness should be treated no differently than loss resulting from sale and the situation is governed by the *Remington Rand* decision." (Italics ours.)

The facts in the instant case are almost identical with those in the case from which the above quotation is taken.

The only other conflict suggested by the petitioner is with the decision of the Circuit Court of Appeals of the Second Circuit in *Auto Sales Corporation vs. Commissioner,* 43 F. (2d) 931 (C. C. A. 2). Here, the petitioner does not claim a similarity of issues but merely claims that the court below erred in holding that affiliation applies only to corporations actively engaged in business. It is

submitted that the court below only held that the affiliation rules do not apply to a going corporation and its subsidiary which has been completely liquidated and is only awaiting completion of the formal and technical dissolution. In the *Auto Sales Corporation* case the opinion shows that the affiliate or subsidiary, as to whom affiliation was required, owned tangible and intangible assets, which the parent corporation claimed to be worth $1,348,557.50 (43 F. (2d) 932) and had outstanding mortgage trust bonds of a par value of $406,800 (43 F. (2d) 935) (which also indicates the existence of assets). These assets were apparently leased to the parent corporation (43 F. (2d) 935). The claim of conflict between the decision in the court below and the decision in *Auto Sales Corporation vs. Commissioner,* 43 F. (2d) 931 (C. C. A. 2), seems to involve a seizure of phrases from the opinions of the respective courts without regard to the contexts or the facts. Even on this narrow point, not only is there no conflict with the *Auto Sales Corporation* case, but also the decision of the court below is in harmony with *Wilmington Steamboat Company vs. Sturgess,* 52 F. (2d) 210 (D. C. N. J.) [affirmed 55 F. (2d) 831 (C. C. A. 3)], and *American Printing Company vs. United States,* 53 F. (2d) 98 (D. C. Mass.).

Thus the only two decisions which are even suggested by the petitioner to be in conflict with the instant case are disposed of; and, as hereinafter presented, the many harmonious cases, including those cited by the court below, are not distinguishable.

B.

The decision of the court below is in harmony with all other cases.

There are a number of decisions on facts similiar to those in the instant case, most of them being cited by the court below (r. 38). These cases include:

Remington Rand, Inc. vs. Commissioner, 33 F. (2d) 77 (C. C. A. 2) certiorari denied 280 U. S. 591.

United Publishers' Corporation vs. Anderson, 42 F. (2d) 781 (S. D. N. Y.).

Wilmington Steamboat Company vs. Sturgess, 52 F. (2d) 210 (D. C. N. J.) affirmed 55 F. (2d) 831 (C. C. A. 3).

American Printing Company vs. United States, 53 F. (2d) 98 (D. C. Mass.).

Canal-Commercial National Bank vs. Commissioner, 22 B. T. A. 541.

H. Liebes & Company vs. Commissioner, 23 B. T. A. 787.

Riggs National Bank vs. Commissioner, 17 B. T. A. 615, affirmed 57 F. (2d) 980 (C. C. A. 4).

Houghton & Dutton Co. vs. Commissioner, 26 B. T. A. 52.

Emerson Carey Fibre Products Co. et al vs. Commissioner, 26 B. T. A. ....., (July 19, 1932 Dockets 36381, 36382).

The petitioner, in his brief, asserts that, of these cases, those cited by the court below are distinguishable. He mentions in the cases of *Remington Rand, Inc. vs. Commissioner,* 33 F. (2d) 77 (C. C. A. 2) (certiorari denied 280 U.

S. 591), and *United Publishers' Corporation vs. Anderson,* 42 F. (2d) 781 (S. D. N. Y.), that these involved sales of the stock to outside interests as distinguished from liquidation and dissolution. This distinction is unsubstantial since, historically, amounts received in liquidation have been treated as if they were amounts received in sale of the stock. This treatment has been prescribed by the statutes themselves in each Revenue Act since that of 1918 where it first appeared specifically as follows in Section 201 (c) [2] of the Revenue Act of 1918 (Act February 24, 1919, c. 18, Title II, 40 Stats. 1057):

> "Sec. 201 (c) [2]. Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits."

We do not understand that petitioner seriously contends that this rule does not apply to the year 1917. In fact, the petitioner apparently undertakes to distinguish these two cases on the ground that separate returns were filed for the period of the year ensuing after the sale of the stock. This ground for distinction was presented to the court below by the petitioner and was apparently regarded as unsubstantial, since the court cited these two cases as authority for its decision here. It was again and more specifically presented to the court below in the petitioner's petition for rehearing, which petition was denied without opinion.

Petitioner distinguishes the case of *Riggs National Bank vs. Commissioner,* 17 B. T. A. 615 [affirmed 57 F. (2d) 980 (C. C. A. 4th)] on the ground that the merger there was "equivalent to dissolution of the subsidiary" (p. 12 Peti-

tioner's Br.). He fails to state how the merger was equivalent to a dissolution and in fact the reported case before the Board of Tax Appeals, as well as in the Circuit Court of Appeals, fails to show when the dissolution did occur. On the contrary, the Circuit Court in that case, whose decision was made subsequent to the decision in the instant case, cited the instant case as authoritative for allowing the loss (57 F. (2d) 980, 983). Thus two of the Circuit Courts have concluded that the instant case should not be distinguished from that of *Riggs National Bank vs. Commissioner,* 17 B. T. A. 615 [affirmed 57 F. (2d) 980 (C. C. A. 4)].

The petitioner states that in *Canal-Commercial National Bank vs. Commissioner,* 22 B. T. A. 541, "there was an actual dissolution on the same day that the liquidation occurred" (Petitioner's Br. p. 13). The reported decision fails to show that this was the fact, but in any event the petitioner, who in that case taxed the gain which corresponds to the denied loss here, does not explain how this could be done in view of his argument here, since the liquidation occurred on the last day of the year, as in the case at bar, and there was an absence of the *separate* period whose presence in the three cases previously discussed is relied on by the petitioner to distinguish them.

In *American Printing Company vs. United States,* 53 F. (2d) 98 (D. C. Mass.), the petitioner shows that the subsidiary ceased to do business on December 31, 1917, as here, and was dissolved "soon thereafter". These facts, which exist here and are alleged to distinguish the instant case from others which have been discussed, nevertheless did not prevent the petitioner from subjecting the gain in that case to normal income taxes. It is true that the case came

into the courts on the question of the basic valuation to be allowed in 1919 on the property thus acquired and that the petitioner did not subject the gain to the excess profits tax, but the decision not only shows the petitioner had taxed the gain for normal taxes, but it specifically makes this the ground for refusing to allow the transaction to be treated as "intercompany". The fact that the case arose on the question of valuation of assets subsequent to the liquidation in no way distinguishes the application by the court of the principles which have been followed in the instant case.

The petitioner distinguishes *Wilmington Steamboat Company vs. Sturgess,* 52 F. (2d) 210 [(D. C. N. J.) affirmed 55 F. (2d) 831 (C. C. A. 3)] on the ground that the court there held that the cost of the subsidiary stock was such that there was no loss in fact, but nevertheless the District Court first squarely determined that the liquidation of the affiliated corporation was such an event as would warrant the deduction of the loss, if any had occurred.

The court below also cited *American Paper Exports, Inc. vs. Bowers,* 54 F. (2d) 508 (C. C. A. 2). This case does not involve facts similar to the instant case, but was cited by the respondent in its briefs below and by the court, on the erroneousness of petitioner's contention there that a separate tax period should have been recognized by the respondent for the fractional day subsequent to the breaking of the affiliation by the liquidation.

Subsequent to the decision of the Board of Tax Appeals in the instant case (which has since been reversed by the court below), the Board decided the case of *H. Liebes & Company vs. Commissioner,* 23 B. T. A. 787, and, without

citing its own decision in the instant case, held, on facts almost identical with the instant case and against the argument of the petitioner on the same issues as are here presented, that the loss should be allowed, distinguishing the case of *Utica Knitting Company vs. United States,* 68 Ct. Cls. 77 (certiorari denied 281 U. S. 739), as hereinbefore stated (supra p. 5).

Thereafter in *Houghton & Dutton Co. vs. Commissioner,* 26 B. T. A. 52, and in *Emerson Carey Fibre Products Co. et al vs. Commissioner,* 26 B. T. A. ....., (July 19, 1932, Dockets 36381, 36382), in each case, on similar facts, the Board held that the loss on liquidation should be allowed and specifically held that there was no material distinction between the case at bar and that before the Board, citing the decision of the court below reversing the Board in the instant case, as authoritative.

The Board of Tax Appeals does not always hold itself bound to follow a decision of the Circuit Court of Appeals. [*Riggs National Bank vs. Commissioner,* 17 B. T. A. 615 (620), (affirmed 57 F. (2d) 980) (C. C. A. 4); *Mrs. Frank Andrews vs. Commissioner,* 26 B. T. A. ....., (July 13, 1932, Docket No. 46734)].

It is apparent that the Board of Tax Appeals has accepted the decision of the court below in the case at bar as correct and in harmony with other cases and in so doing has receded from its primary position in the instant case.

II.

The Issues Arise Under a Statute Long Since Repealed. They Are Not of General Importance and Involve no Great Principle.

Petitioner asserts that the question of whether, in computing net income, intercompany transactions are to be disregarded under circumstances similar to those presented at bar is one of general importance affecting substantial sums and taxes and a number of taxpayers.

The instant case arises under Title II of the Revenue Act of 1917 (Act October 3, 1917, c. 63, 40 Stats. 300) Title II providing for War Excess Profits Tax. This form of tax applied only to the incomes of the years preceding 1922, as contained only in the said act, the Revenue Act of 1918 (Act February 24, 1919, c. 18, 40 Stats. 1057) Title III and the Revenue Act of 1921 (Act November 23, 1921, c. 136, 42 Stats. 227) Title III. It may be that a similar question might arise under the Revenue Act of 1924 (Act June 2, 1924, c. 234, 43 Stats. 253) Title II and the Revenue Act of 1926 (Act February 26, 1926, c. 27, 44 Stats. 9) Title II relative to consolidated returns for normal income tax. The question could not arise under the Revenue Act of 1928 (Act May 29, 1928, c. 852, 45 Stats. 795) Title I or the Revenue Act of 1932 (Act June 6, 1932) Title I for the reason that under Section 141 of each of those Acts the filing of consolidated returns is made a privilege upon condition that the affiliated corporations consent to all regulations prescribed by the Commissioner of Internal Revenue for determining the tax liability of an affiliated group and the petitioner is at liberty to prescribe his views on the question at issue as a condition to the privilege of filing consolidated returns. Consequently the petitioner is in

error in his petition in stating that "the question arises under all of the Revenue Acts since the Revenue Act of 1917" (Petition p. 6).

Under Section 275 of the Revenue Act of 1928 (26 U. S. Code § 2275) and under Section 277 of the Revenue Act of 1926 (26 U. S. Code § 1057), income taxes are required to be assessed respectively within two and three years after the return was filed. Consequently, the question in the case at bar arises under a form of taxation which has been non-existent for over ten years and which can arise relative to other forms of taxes only in the cases of those taxpayers who, by waiver or agreement, have waived the application of the said statutes of limitation. The question cannot arise as to any years that are open to assessment under the statute, except in the comparatively few cases of waiver or agreement as aforesaid.

The petitioner or his predecessors in office undertook to collect taxes on gains and prevailed under circumstances similar to those in the instant case on the ground that the sale or liquidation of the stock of a subsidiary was not an "intercompany" transaction. [*Remington Rand, Inc. vs. Commissioner,* 33 F. (2d) 77 (C. C. A. 2), (certiorari denied 280 U. S. 591); *American Printing Company vs. United States,* 53 F. (2d) 98 (D. C. Mass.); *Canal-Commercial National Bank vs. Commissioner,* 22 B. T. A. 541]. The petitioner or his predecessors in office have sought to deny deductions for losses under circumstances similar to those in the instant case and have in each instance been defeated [*Burnet vs. Riggs National Bank,* 17 B. T. A. 615, affirmed 57 F. (2d) 980 (C. C. A. 4); *Wilmington Steamboat Company vs. Sturgess,* 52 F. (2d) 210 (D. C. N. J.), affirmed 55 F. (2d) 831 (C. C. A. 3), where the loss was held allowable as a matter of law, but denied on facts; *Canal-Commercial National Bank vs. Commissioner,* 22 B. T. A. 541; *United*

Publishers' Corporation vs. Anderson, 42 F. (2d) 781 (S. D. N. Y.)].

The case of *Canal-Commercial National Bank vs. Commissioner,* 22 B. T. A. 541, has been mentioned above as one in which the petitioner was permitted to tax the gains and also has been listed as one in which the petitioner sought to deny the loss, for the reason that the Board of Tax Appeals first determined that the loss claimed by the taxpayer and denied by the Commissioner was allowable as a matter of law and then determined that, as a matter of fact, there was a gain instead of a loss in the transaction, as claimed alternatively by the petitioner.

The only case in which a transaction in any way like that here in controversy was held to prevent recognition of gain or loss was that of *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77, certiorari denied 281 U. S. 739, which is distinguishable on the facts as hereinbefore set forth.

III.

The Decision of the Circuit Court of Appeals is Correct and Recognizes Substance as Well as Form.

This court in *The Farmers Loan & Trust Company vs. Minnesota,* 280 U. S. 204, said:

> [280 U. S. 212] "Taxation is an intensely practical matter and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. * * *"

Disregarding all discussion on form and considering only substance (although the respondent asserts that the decision below is correct on form as well as substance), the case at bar presents a situation on which the respondent

over a period of years advanced money in the course of its business operation to a subsidiary which lost the money. During the years in which the subsidiary lost the money, there was no consolidation of returns and the respondent did not have the benefit of the deduction of the subsidiary's losses from its income. The losses of the subsidiary which occurred in the year 1917, when consolidated returns were filed, are not claimed by the respondent as a loss, since it has had the deduction through the consolidation. The losses of the respondent's money as advanced to its subsidiary are allowable, if at all, only in the year 1917. As the court below said "In the instant case it is impossible to escape the conclusion that petitioner suffered a loss. That the loss was sustained in 1917, if at all, is admitted" (r. 37).

The petitioner seeks to deny for all time the deduction of the loss on the ground that its final form involved an "intercompany" transaction. *As the court below said, an intercompany transaction which is to be eliminated under the rules of the Treasury Department is one where a loss to one affiliate is represented by a gain to another and it held that the transaction here in question was not that type of intercompany transaction.* The word "intercompany" does not appear in the statutes at all. To apply this very proper departmental rule to transactions to which it was never intended to apply and cannot logically apply, is to apply the rule in a way which *defeats its very purpose* of determining the true taxable income. This is proposed merely because of the language in which the rule is couched. It is submitted that the petitioner seeks to pursue form, and erroneously, to the denial of substance, and contrary to both the letter and the spirit of the statutes.

CONCLUSION.

The decision of the Circuit Court of Appeals is correct. It is in harmony with all of the cases containing similar facts. The questions at issue are not of general importance and can arise only as to years as to which the statutes of limitation have run.

The respondent has endeavored for over ten years of controversy with the petitioner or his predecessors to secure a final determination of its 1917 taxes in accordance with its view of the law. The decision of the Circuit Court of Appeals is just. It is submitted that the controversy should be ended by a denial of the petition for certiorari.

Respectfully submitted,

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
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Counsel for Respondent.

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In the Supreme Court of the United States

October Term, 1932.

No. 192.

DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

ALUMINUM GOODS MANUFACTURING COMPANY,

Respondent.

Brief for the Respondent.

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
J. GILBERT HARDGROVE,
Counsel for Respondent.

Frederic Sammond,
Paul F. Myers,

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Brief for the Respondent.

REFERENCE TO OFFICIAL REPORT OF THE OPINIONS BELOW.

The findings of fact and opinion of the Board of Tax Appeals (R. 10 to 21) are reported in 22 B. T. A. 1. The opinion of the Circuit Court of Appeals (R. 25-28) was reported in 56 F. (2d) 568.

STATEMENT OF THE CASE.

The summary in the petitioner's brief of the facts, as agreed upon by the parties and accepted by the Board of Tax Appeals (R. 10-15) is accurate; but the following facts omitted in the summary, also must be given consideration:

As stated by the petitioner, the respondent acquired all of the capital stock of Aluminum Sales & Manufacturing Company (hereinafter referred to as the "subsidiary") in 1914 for $29,749.80 and, in addition, at the close of 1917 had owing to it by the subsidiary $47,486.31. As stated by the petitioner, the subsidiary was chiefly engaged in 1917 in liquidating its assets and transacted no business after 1917. The respondent adds that all of the assets and liabilities of the subsidiary were disposed of by the end of 1917, including the transfer to the respondent of its remaining equipment and its good will, which transfer occurred in 1917 (R. 11). The value of the said equipment and good will received by the respondent in 1917 and applied upon its investment in and advances to the subsidiary was $10,684.56 (R. 11). The loss allowed the respondent as a deduction in determining its normal tax for 1917 was computed as follows (R. 12):

Investment in capital stock of subsidiary	$29,749.80	
Advances to subsidiary	47,486.31	
		$77,236.11
Less value of good will and equipment received in 1917 from subsidiary		10,684.56
Total loss claimed and allowed for normal taxes		$66,551.55

The amount of the loss claimed by the respondent in its consolidated return of 1917 for excess profits tax purposes and wholly disallowed by the petitioner was and is $51,861.90, being the difference between the said loss of $66,551.55 and $14,689.65, which was the operating loss of the subsidiary for 1917 included in said consolidated return (R. 12). During the years 1914 to 1917, inclusive, the respondent was the sole owner of all of the capital stock of the subsidiary (R. 12). As stated by the petitioner, sep-

arate tax returns were filed by the respondent and the subsidiary for the years 1914 to 1917, inclusive, except that a consolidated return of the two corporations was filed for excess profits taxes only for the year 1917. Formal certificate of dissolution of the subsidiary was filed with the Secretary of State of the State of New York on February 21, 1918, showing that the Board of Directors of the subsidiary on January 10, 1918, adopted resolutions providing for its dissolution forthwith and that the stockholders of the subsidiary adopted such dissolution resolution on February 11, 1918, (R. 13).

SUMMARY OF ARGUMENT.

I. The loss claimed is admittedly deductible in 1917 if ever, and is admittedly allowable then unless the petitioner's contention is sustained that its allowance be barred because the transaction is "intercompany," and within an affiliated return period. Neither of these conditions exists. The established administrative rules relative to "intercompany" transactions do not apply to a final distribution by a subsidiary, and those relied on by petitioner were adopted after the tax became assessable. If such rules did cover such transactions as that here, they may not be retroactively applied and, as the court below held, "can be sustained only in so far as it [the practice] does not run counter to the provisions of the statute" (R. 27). "Intercompany" is an accounting term having a special meaning not applicable to the transaction at issue. The allowance of the loss here is compatible with the true purpose of consolidated returns. Affiliation here was terminated by a final distribution of assets of the subsidiary.

II. Taxation is a practical matter. Almost all losses and gains upon disposition of property represent a "carrying

forward" of losses and gains economically accrued earlier and that fact does not affect their treatment for taxation when realized. The consolidated invested capital of the respondent and subsidiary may have been more or less than the invested capital of the respondent alone, and it was probably less; but this is not material to deductibility of loss when realized.

III. The petitioner's argument that, if the losses are allowable here, they are non-effective and the deficiency is the same because of the absence of sufficient income on the last day of the year, presupposes the requirement of a separate tax return for such day or a fraction thereof. This supposition is unsound and contrary to the petitioner's long established practice and regulations.

IV. All courts which have passed upon the question, as well as the Board of Tax Appeals, have held consistently with the court below for the position taken by the respondent on similar facts. The petitioner relies upon one case which is claimed to be in conflict with the many consistent cases and another case as in conflict to a limited extent. These two cases are easily distinguishable and have been distinguished. The petitioner distinguishes the case at bar from other consistent cases on the ground that the formal dissolution of the subsidiary's empty shell occurred in the following year, a few weeks after the final distribution of the subsidiary's assets. This circumstance is not only immaterial, but it existed in some of the cases which are in accord with this one. This argument was emphatically rejected by the court below (R. 28). The Board of Tax Appeals, which originally decided against respondent in the case at bar, has accepted the decision of the Circuit Court of Appeals as authoritative, although holding that it is not bound by such decisions; and it has

followed this decision in four recent cases during the pendency of the proceeding in this court. This decision has also been followed and cited with approval by the Circuit Court of Appeals for the Fourth Circuit.

Argument.

I.

THE LOSS IS DEDUCTIBLE; IT IS NOT "INTERCOMPANY" OR WITHIN AN AFFILIATED RETURN PERIOD.

A.

The Loss is Deductible.

The statutes quoted in the petitioner's brief (p. 27) grant the right of deduction of losses in determining net income of 1917 for normal taxes and for excess profits taxes. Losses on sale of stocks are allowable without question and amounts received in liquidation have always been treated as received in sale of the stock. This was first specifically provided in the Revenue Act of 1918 (Act February 24, 1919, c. 18, Title II, 40 Stats. 1058) as follows:

> "Sec. 201 (c)[2]. Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits."

This provision has been continued in other Revenue Acts; it codifies a legal conclusion and it has been applied retroactively to 1917 by the petitioner in the case at bar (in allowing the loss here for normal taxes) as well as in other cases.

B.

The Loss is Allowable Only in 1917.

This loss was deductible in 1917 only and was not deductible in any earlier or later year. Until 1917 the subsidiary continued in business and had assets, and the possibility of recovery as well as the possible amount thereof was undeterminable *(News Publishing Company vs. Commissioner,* 6 B. T. A. 1257 (1265), affirmed (without discussion of this point) 29 F. (2d) 955 Ct. App. D. C.). Similarly, the deduction of the loss could not be deferred beyond 1917 after the subsidiary had ceased to have assets or operate.

In *DeLoss vs. Commissioner,* 28 F. (2d) 803, 804 (C. C. A. 2), certiorari denied 279 U. S. 840 (affirming 6 B. T. A. 784), a loss upon shares sold in 1921 was denied on the ground that the loss was sustained in 1920 when they became worthless. Similar conclusions were reached in *Russell Wheel & Foundry Company vs. Commissioner,* 3 B. T. A. 1168, and *John W. Mercer vs. Commissioner,* 6 B. T. A. 564.

Moreover, the loss in question has been allowed to the respondent in 1917 for normal tax purposes. As the respondent joins the petitioner in believing that the loss is allowable in 1917, if at all, and has maintained this position consistently, it is difficult to grasp the statement in the footnote at page 18 of petitioner's brief that the respondent cannot complain if the Commissioner's allowance of the deduction for normal tax purposes was erroneous. The respondent has never contended that this allowance of this deduction was erroneous. It appears that petitioner's sole ground for disallowing the loss is the fact that respondent was affiliated with the subsidiary during 1917 and filed a consolidated return for excess profits tax purposes as was required.

C.

This is Not an "Intercompany" Transaction.

Where affiliation existed and the parent corporation sold stock of the subsidiary, the courts have held, on the argument of the petitioner or his predecessors, that the loss or gain should be recognized for tax purposes and that the transaction took place "outside" of the consolidated return period.

Remington Rand, Inc., vs. Commissioner, 33 F. (2d) 77, C. C. A. 2 (certiorari denied 280 U. S. 591).

United Publishers' Corporation vs. Anderson, 42 F. (2d) 781, S. D. N. Y.

Obenchain-Boyer Company vs. Commissioner, 18 B. T. A. 293.

We do not understand that the petitioner challenges this view. It follows that his position rests on the fact that this is a liquidation rather than a sale, despite the similarity between liquidation and sale as recognized in the statutes, as hereinbefore stated. This is claimed to result because the transaction was "intercompany."

The word "intercompany" does not appear in the statutes and the elimination of intercompany transactions is an accounting corollary of the consolidation of returns. The word "intercompany" represents nothing but an accountant's rule to accomplish the proper statutory *purpose of presenting the group as an economic unit* and to prevent the duplication or "pyramiding" of income and losses.. If applied to such a situation as this, the rule would serve only to eliminate the loss entirely so that neither the group nor any of its members is allowed the loss. Thus the application of a proper working rule is proposed to defeat its very purpose, merely because of the language in

which it is couched. A phrase is to be permitted to erase realties. Sometimes tax cases are of necessity decided on purely verbal grounds, but these are cases where the applicable words are contained in the statutes.

It is submitted that "intercompany" transactions, which are to be properly eliminated upon a consolidation of returns, are transactions where the loss by one member of a group is the gain of another. Here the loss to the parent arises from stock originally purchased from outsiders and from loans to the subsidiary which became uncollectible because of losses by the subsidiary in its dealings with third parties. The court below adopted this view (R. 27, 28). Actual losses were suffered by the group and their disallowance is proposed because of the mere fact that the liquidation of the subsidiary—the incident which fixes only the realization of the loss and not its occurrence—can be called "intercompany."

The purpose of Congress in requiring or at times only permitting consolidated returns is to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise *(Handy & Harman vs. Burnet,* 284 U. S. 136, 52 Sup. Ct. Rep. 51), and this is recognized by the respondent. In pursuance of the rule, it is proper to eliminate from consideration transactions which arise between two members or parts of the enterprise. The loss here did not arise from the transfer to the parent, at the death of the subsidiary, of equipment and good will of a value of only $10,684.56. This transfer only marked the termination of the possibility of diminution of the loss, and the final determination of the exact amount of the loss, i. e., the realization fact. The loss itself was of the respondent's money invested over a period of years in the stock and advances to the subsidiary. The loss was realized when the worth-

lessness of the investment was determined. *(De Loss vs. Commissioner,* 28 F. (2d) 803, 804, certiorari denied 279 U. S. 840. It seems to be the petitioner's position that this transfer of a negligible amount of salvaged equipment, which has been duly credited against the loss, makes the loss "intercompany" and that, therefore, the whole loss should be eliminated to get at the true income of the whole enterprise. The respondent submits that the contrary is true.

D.

If There is a Contrary Administrative Practice, It Has No Retroactive Effect.

The petitioner asserts that his position here is consistent with administrative practice heretofore (Petitioner's Br. pp. 12, 13). He cites a Solicitor's Opinion and two General Counsel Memoranda. The earliest of these, Solicitor's Opinion 131 C. B. I-1, p. 18, if it properly can be regarded as the position of the Bureau of Internal Revenue, was issued in 1922. The transaction at bar occurred in 1917.

In *Woolford Realty Company vs. Rose,* 286 U. S. 319, this court said:

> [286 U. S. 330] "* * * These provisions were adopted after the liability for the tax of 1927 had accrued, and they can have little bearing upon the meaning to be given to statutes then in force. * * *"

The petitioner also refers to the Bureau's practice ultimately finding expression in Treasury Regulations 75, Art. 37. Treasury Regulations 75 differed from all other regulations in that they are prescribed as binding upon a taxpayer in consideration of the taxpayer availing himself of the *privilege* of making a consolidated return (Revenue Act of 1928, Ch. 852; 45 Stats. 791, §141 (a) and (b); U.

S. C. Title 26, §2141). It has no weight whatever in connection with the determination of 1917 income for war excess profits tax purposes, where a consolidation return was not optional but compulsory.

E.

Affiliation Here Was Termniated.

The courts have repeatedly held that the sale by a parent of stock of its subsidiary, which sale "breaks the affiliation" occurs outside of the affiliated period and gives rise to taxable gain or loss *(Remington Rand, Inc., vs. Commissioner,* 33 F. (2d) 77 (certiorari denied 280 U. S. 591)) and we do not understand that the petitioner holds otherwise. Wherever the question has been presented, courts have held also that a liquidation (final distribution) by a subsidiary has similar results and terminates the affiliation.

Burnet vs. Riggs National Bank, 57 F. (2d) 980.

Wilmington Steamboat Company vs. Sturgess, 52 F. (2d) 210, affirmed 55 F. (2d) 831.

Canal-Commercial National Bank vs. Commissioner, 22 B. T. A. 541.

In none of these cases is there any weight attached to the formal *dissolution* of the subsidiary as the effective act and in all of them it is the final distribution of assets which is considered. It is not respondent's position, as petitioner seems to believe (Petitioner's Br. pp. 10, 11), that the subsidiary's cessation of activities terminated the affiliation or had any other effect. It *is* respondent's position that, upon the subsidiary's divesting itself of all assets and becoming a mere empty shell, the loss actually sustained became ascertained for all time and that the continued existence of the subsidiary for a few weeks pending formal dissolution is immaterial. If it had not been dissolved, it could only have re-entered the financial situation

and the consolidated return by the investment of new money and the starting of another enterprise, which in turn would initiate a new series of transactions and relationships unrelated to the transaction at bar.

The petitioner seems to maintain that the formal act of filing the dissolution paper would constitute all that is necessary to make the loss deductible, for what else can be meant by the statement at page 21 of petitioner's brief—"The fact that this situation might have been easily avoided is not material. The tax laws are replete with instances where apparently formal action would alter the results reached, but the presence of some loopholes in the taxing statutes does not warrant judicial expansion of their number." The respondent does not make the claim that the situation might have been easily avoided or that a formal action would alter the results reached. On the contrary, if filing a dissolution paper is the formal action to which petitioner refers, respondent believes that it is entirely immaterial and has no effect on the transaction.

F.

Invested Capital and Net Income Are Used Consistently.

Petitioner suggests that respondent seeks to have its taxes determined upon the basis of its separate net income at rates determined by the use of consolidated invested capital (Petitioner's Br. p. 22). This is not the result. Respondent does not seek to have its separate net income determined. On the contrary it has consistently dealt with the consolidated net income of the enterprise. It maintains that the consolidated net income was reduced by a bona fide loss which had accrued over a period of years and became legally recognizable upon realization in 1917. *It was not an intercompany loss, since the loss of one mem-*

ber was not reflected as gain to another member of the group, either in this year or at any other time.

The rates of taxation are, of course, determined by the consolidated invested capital for the period of affiliation. The record does not show whether the respondent's separate invested capital would be more or less than the consolidated invested capital. In the nature of things, respondent's separate invested capital would be more, since it would include as part of its assets, its investment in the subsidiary at the full amount thereof until the date of realization of the loss. The consolidation of two corporations to determine the consolidated invested capital involves the substitution of the subsidiary's invested capital for the parent's investment in the subsidiary. The facts of the loss here show that the net worth of the subsidiary in 1917 was considerably less than the parent's investment therein. However, whatever the relationship between the separate invested capital and the consolidated invested capital, respondent maintains that neither separate invested capital nor separate net income is involved in the case.

II.

ALMOST ALL LOSSES AND GAINS UPON THE DISPOSITION OF PROPERTY REPRESENT A "CARRYING FORWARD" OF THE EFFECT OF PRIOR CHANGE IN VALUE.

"Taxation is an intensely practical matter and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. * * *"

The Farmers Loan & Trust Company vs. Minnesota, 280 U. S. 204 (212).

Nearly every loss or gain arising from the disposition of property represents an accumulation over several taxing periods of an accruing increase or decrease in value which becomes a gain or loss recognizable for tax purposes upon realization. As this court said in *MacLaughlin vs. Alliance Ins. Co. of Philadelphia*, 286 U. S. 244:

> [286 U. S. 249] "* * * Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property, not realized as gain by its sale or other disposition, may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period, see Merchants' Loan & Trust Co. vs. Smietanka, 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305, it is nevertheless a gain from capital investment which, when realized, by conversion into money or other property, constitutes profit which has consistently been regarded as income within the meaning of the Sixteenth Amendment and taxable as such in the period when realized, see Lynch vs. Hornby, 247 U. S. 339, 38 S. Ct. 543, 62 L. Ed. 1149; Merchants' Loan & Trust Co. vs. Smietanka, supra; Eldorado Coal & Mining Co. vs. Mager, 255 U. S. 522, 41 S. Ct. 390, 65 L. Ed. 757; Goodrich vs. Edwards, 255 U. S. 527, 41 S. Ct. 390, 65 L. Ed. 758; Walsh vs. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762; Taft vs. Bowers, 278 U. S. 470, 49 S. Ct. 199, 73 L. Ed. 460, 64 A. L. R. 362; Lucas vs. Alexander, 279 U. S. 573, 49 S. Ct. 426, 73 L. Ed. 851, 61 A. L. R. 906; Willcuts vs. Bunn, 282 U. S. 216, 51 S. Ct. 125, 75 L. Ed. 304."

There is, therefore, no materiality in petitioner's argument (Petitioner's Br. p. 22) that the respondent seeks to carry forward to the year 1917 all the operating losses of the subsidiary in prior years. The same assertion would be true of a loss or gain on any investment in capital stock by any taxpayer, regardless of affiliation questions.

Similarly, the petitioner asserts that the allowance of this loss would be to allow indirectly the carrying forward of a deduction for losses which this court has said may not be accomplished directly, citing *Woolford Realty Company vs. Rose,* 286 U. S. 319, 52 Sup. Ct. Rep. 568, and *Planters' Cotton Oil Company vs. Hopkins,* 286 U. S. 332, 52 Sup. Ct. Rep. 509. These two cases related to the statutory provision for carrying forward the excess of deductions over gross income of one year and deducting the same from the income of a subsequent year *by the same taxpayer.* This statutory provision has nothing to do with the deductibility of a loss on assets at the time it is *realized.* In fact, the two cases just cited are based upon the fundamental theory that each of two or more corporations joining in a consolidated return is none the less a taxpayer and that a corporation does not cease to be such a person by affiliating with another (*Woolford Realty Company vs. Rose,* 286 U. S. 319, 328). This rule is consistent with respondent's fundamental theory on the case at bar that a realized loss suffered by one member of an affiliated group is none the less deductible because it is based upon investment in another member of the group.

The argument is advanced by the petitioner (Petitioner's Br. p. 17) that the parent's gain or loss results solely by a shifting of property and accounts between members of the same affiliated group, which does not affect the financial situation of the enterprise viewed as a whole and that the assets of the group were neither increased nor decreased (Petitioner's Br. p. 13). This is true of any loss or gain recognizable for tax purposes, whether involving an affiliated group or not. Before a loss or gain is recognizable, i. e., realized, the value of the assets nevertheless may have changed. At the moment of realization, there is no change in the values. It is not a true test of

realization of a loss to consider whether a taxpayer's assets are less after the realization than before. The test is whether the assets have been diminished over the period between their acquisition and the termination of their value. The test of whether a certain transaction represents a realization of a gain or loss is not whether the taxpayer had something more or less afterward than before, but whether he had something different or had nothing at all, and whether the value of that different thing, if any, was more or less than the original cost to him of what he previously had.

III.

PETITIONER'S ALTERNATIVE ARGUMENT THAT UPON TERMINATION OF AN AFFILIATION ON THE LAST DAY OF THE YEAR, A SEPARATE RETURN WOULD BE REQUIRED FOR SUCH DAY OR A FRACTION THEREOF IS UNFOUNDED.

As an alternative argument, petitioner asserts that if the court below was correct in deciding that the loss was not intercompany, and that affiliation was terminated by the final distribution, then the loss fell on the parent on the last day of the year and was allowable only on that day, on which there presumably was insufficient income against which to credit the loss, and that, therefore, the allowance of the loss should be noneffective in determining the tax (Petitioner's Br. pp. 23-26). This argument presupposes a requirement for a separate return on the last day of the year; but there is no such requirement, and in fact such supposition is contrary to the petitioner's well-settled practice and regulations. This argument was the basis of petitioner's petition for rehearing in the court

below which, after the filing of briefs, was denied without opinion (R. 30).

The tax to be determined here is that of the respondent, the parent corporation. It is affected, it is true, by the operating gain or loss of the subsidiary during the affiliated period. Nevertheless the respondent remained a separate corporation and taxpayer during said year (*Woolford Realty Company vs. Rose,* 286 U. S. 319), and the petitioner cites no statute or even regulation suggesting that respondent's taxable year should be broken into two parts, of 364 and a fraction days and a fraction of one day, respectively, or that two taxes for respondent for said year should be determined. On the contrary, the statute expressly provides for a single return for the whole year.

Section 13 (a) of the Revenue Act of 1917 (Act Sept. 8, 1916, C. 463 Title I, 39 Stats. 756, Amended Oct. 3, 1917, C. 63 Title I, 40 Stats. 300) provides as to corporations:

> "The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first [followed by proviso for return covering fiscal *year*]."

The war excess profit tax is on the same basis (Sec. 206; set forth in Petitione 's Brief p. 27).

A holding in *Sweets Company of America vs. Commissioner,* 40 F. (2d) 436, C. C. A. 2, on dissimilar facts which might have served as authority for petitioner's position relative to a separate return, was modified by an opposite conclusion of the same court in *American Paper Exports, Inc., vs. Bowers,* 54 F. (2d) 508.

The Board of Tax Appeals (which as hereinafter stated, has receded from its original position in the case at bar

and has cited the decision of the Circuit Court of Appeals here as authoritative in a number of cases) recently decided a case in favor of a taxpayer, on facts indistinguishable from those at bar, to the effect that the loss on the liquidation of the subsidiary was deductible *(Houghton & Dutton Co. vs. Commissioner,* 26 B. T. A. 52). There too the distribution was claimed to have occurred after the close of business on the last day of the year and, when the parties later came before the Board for a determination of the deficiency in the light of the said opinion, the Commissioner similarly asserted that the loss was non-effective. The Board denied this contention in an opinion, promulgated October 31, 1932, 26 B. T. A. ....., from which we quote as follows:

> "On recomputation under Rule 50, the petitioner claims the several deductions in their full amounts from its income for the entire year. Respondent takes the position that the deductions are allowable from petitioner's income only for the period within the year that is outside the period of affiliation, and that as the only period of this kind was the brief interval between the close of business on the last day of the year and the end of the year, during which petitioner had no income, there is nothing from which the several deductions may be taken.
>
> "We think that respondent's position in this respect is erroneous. Deeply rooted in the Federal tax system is the fundamental idea of computation of taxes on an annual basis. *Burnet vs. Sanford & Brooks Co.,* 282 U. S. 359; *Burnet vs. Thompson Oil & Gas Co.,* 283 U. S. 301. Even though affiliated with others, each corporation is still a taxpayer, *(Woolford Realty Co., Inc., vs. Rose,* 286 U. S. 319), and as such is entitled to have its taxes computed on the basis of its taxable year, which requires that it report all income received within the year as yearly, and not daily, income, and carries with it the correlative right to all the statutory deductions growing

out of transactions within the year without regard to the particular day on which they occurred.

"It is argued by respondent that his position here is in accordance with Article 634, Regulations 45, as amended by T. D. 4022 (C. B. VI-1, p. 258) which provides that where two corporations are affiliated at the beginning of the year, but, due to a change in stock ownership or control during the year, affiliation is terminated, a consolidated return shall be filed for the period of affiliation, and a separate return should be filed for each for the remainder of the year. The respondent's theory, if carried into practice, would require the filing of a separate return in cases like this for the fractional part of a day between the close of business on the last day and the end of the year.

"The same provisions appear in subsequent regulations (Art. 634, Reg. 62 and 65), but these later regulations provide further that:

> 'in any case in which the consolidated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed.'

The respondent's position as asserted here is contrary to the quoted provision which has now been long established.

"We are unable to perceive the necessity of a separate return by the parent company for the period within the year following the termination of affiliation. The decisions are uniform in holding that where a corporate taxpayer affiliates during the year with a newly organized corporation which has had no separate existence, a single return containing the income of both during affiliation and the separate income of the one prior to affiliation is all that need be filed. *Automatic Fire Alarm Co.* 13 B. T. A. 1195; *Hutt Contracting Co.*, 17 B. T. A. 818; *Margay Oil Corporation*, 26 B. T. A. 199; *American Paper Ex-*

ports, Inc., vs. Bowers, 54 Fed (2d) 508. The decision in the last cited case is based on the premise that under the circumstances there present, the filing of two returns for the one year would be 'contrary to the general theory of an income tax, which does not allow the splitting of years.' The law being thus established by the decided cases, is there any sound reason why the same rule should not apply where, during the year, affiliation is broken by reason of the factual death of the subsidiary corporation? In such a case there is no period within the year during which the subsidiary had a separate existence, hence there was no period for which it would be required to file a separate return. And the reasons which support the propriety of a single consolidated return by the parent where a newly organized corporation comes into the group, as in the cases cited, are sufficient to permit the filing of a similar return where a subsidiary leaves the group and has no further existence. It is true under both situations that there is a period in which the parent may be said to have a 'separate' existence in one sense of the word. But under what we conceive to be the proper view, the absence of another corporation from which the parent's income must be separated for any part of the year is an important and distinguishing feature. In the situations we are discussing here there is, properly speaking, no period of 'separate' existence for either corporation. During all of the time that both were in being they were affiliated. Under such circumstances we are of the opinion that a consolidated return for the entire year is the only return required and that it should include all the parent's income and deductions for the year."

IV.

THE COURTS AND THE BOARD OF TAX APPEALS ARE IN ACCORD WITH THE DECISION HERE.

The courts which have considered facts similar to the case at bar and also the Board of Tax Appeals have held consistently with the respondent's position here.

The Board of Tax Appeals originally decided a number of cases to the contrary, but subsequent to the decision of the Circuit Court of Appeals of the Second Circuit in *Remington Rand, Inc., vs. Commissioner,* 33 F. (2d) 77 (certiorari denied 280 U. S. 591) (in the case of a sale of subsidiary's stock), the Board has held losses deductible and gains taxable on the sale or liquidation of stocks of subsidiaries. The single exception was the case at bar where the Board held the loss not deductible on the authority of *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77, distinguishing the instant case from other cases because of the interval between the liquidating distribution and the formal dissolution. Upon the reversal of the Board by the Circuit Court of Appeals for the Seventh Circuit in the case at bar, the Board has adopted the view of that court as authoritative and has since accordingly decided several cases indistinguishable from the instant case.

The Apartment Corporation vs. Commissioner, 26 B. T. A. 849, (subsidiary allowed to remain in existence until dissolved by proclamation for nonpayment of franchise fees).

The Carey Salt Company vs. Commissioner, 26 B. T. A. 675.

Houghton & Dutton Co. vs. Commissioner, 26 B. T. A. 52, (and supplemental opinion promul-

gated October 31, 1932, 26 B. T. A. .....).

The Prosperity Company, Inc., vs. Commissioner, 27 B. T. A. ..... (Nov. 8, 1932).

The Board of Tax Appeals does not always hold itself bound to follow a decision of the Circuit Court of Appeals.

Riggs National Bank vs. Commissioner, 17 B. T. A. 615 (620).

Mrs. Frank Andrews vs. Commissioner, 26 B. T. A. 642 (649).

Even before the decision of the Circuit Court in the case at bar, the Board had abandoned its original position and allowed a loss under similar circumstances, distinguishing *Utica Knitting Company vs. U. S.*, 68 Ct. Cls. 77, on facts which would be equally effective to distinguish it from the instant case.

H. Liebes & Co. vs. Commissioner, 23 B. T. A. 787.

Other decisions in harmony with the case at bar, involving liquidation and dissolution of subsidiaries are:

Burnet vs. Riggs National Bank, 57 F. (2d) 980 (C. C. A. 4).

American Printing Company vs. U. S., 53 F. (2d) 98 (D. C. Mass.).

Wilmington Steamboat Company vs. Sturgess, 52 F. (2d) 210 (D. C. N. J.), affirmed 55 F. (2d) 831, C. C. A. 3, (without discussion of the point of law).

Charles Ilfeld Company vs. Hernandez, U. S. Dist. Ct. N. Mex., Aug. 19, 1932, [published in full at 323 C. C. H. §9499 (Standard Federal Tax Service of 1932)].

The petitioner relies on *Utica Knitting Company vs. U. S.*, 68 Ct. Cls. 77. To distinguish the case, we only need quote from the opinion therein:

> "It would be an extremely technical evasion of the purpose of the statute [requiring consolidated returns] to hold that a conceded affiliation ceases when the subsidiary ceases to sell and manufacture goods, while at the same time the parent company owns all the stock of the subsidiary, *and the subsidiary continues in business for the purpose of winding up its affairs, turning over its property to the parent, collecting its accounts and paying its debts,* which very debts and accounts arose out of the knitwear business in which both the parent company and the subsidiary were engaged" (Italics ours).

In our case, the subsidiary had already entirely discontinued its business for all purposes, turned over its property to the parent, collected its accounts and paid all its debts except that to the parent.

As heretofore stated, the respondent asserts that its loss was realized upon the final liquidation of the subsidiary's assets and the final distribution of the avails thereof to the parent. The subsidiary's status in the *Utica Knitting Co.* case shown in the above quotation as existing *after* the loss was claimed to have been realized, is the status which *respondent's* subsidiary had *until* and only until the point where the loss was realized.

In *H. Liebes & Co. vs. Commissioner,* 23 B. T. A. 787, (a case similar to the case at bar), the Board of Tax Appeals, after quoting the language above quoted from *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77, made the following statement:

> [23 B. T. A. 791] "It is clear from this quotation that the two cases are different. Here the subsidiary corporation had completely gone out of business be-

fore the end of the year and it had no property to turn over to the parent company.

While it may be that at the end of 1921 petitioner and the Ganss Fur Company were technically affiliated because petitioner still owned the stock, a denial of a loss claim on account of that technicality would be to ignore the substance of the situation. Had the petitioner sold the stock in 1921 for a nominal sum—which was all that could have been realized —the case would clearly come within the case *Remington Rand, Inc., vs. Commissioner,* 33 Fed. (2d) 77. The fact that petitioner failed to go out of its way to attempt to make a sale, when in all probability a bona fide sale could not have been effected, should not affect the result. In our opinion loss resulting from worthlessness should be treated no differently than loss resulting from sale and the situation is governed by the *Remington Rand* decision."

The only other case claimed by the petitioner to be inconsistent is *Autosales Corporation vs. Commissioner,* 43 F. (2d) 931, and on this case the petitioner claims a conflict only to a limited extent (Petitioner's Br. in Support of Petition for Certiorari p. 5). The pertinent facts in that case are shown by the opinion to be such that the subsidiary had assets claimed by the parent to be worth $1,348,-557.50, outstanding mortgage trust bonds of a par value of $406,800 (which also indicates the existence of assets) and these assets were apparently leased to the parent corporation, 43 F. (2d) 931, 932, 935.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

EDWIN S. MACK,
ARTHUR W. FAIRCHILD,
J. GILBERT HARDGROVE,
Counsel for Respondent.

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DEC 12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 192.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,

v.

ALUMINUM GOODS MANUFACTURING COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF.

WARD LOVELESS,
Amicus Curiae.

Washington, D. C.,
December, 1932.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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MAY IT PLEASE THE COURT:

The undersigned having first obtained the consent of both parties respectfully moves this Honorable Court for leave to file the accompanying brief as amicus curiae.

WARD LOVELESS,
Amicus Curiae.

IN THE

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BRIEF OF WARD LOVELESS, AMICUS CURIAE.

This brief is submitted on behalf of clients whose tax liability might be affected by the result in one issue involved in this case. For brevity, formal matters covered in the briefs of the parties are not here repeated. This brief relates only to that one of the issues which affects clients of the undersigned.

Statement.

This case involves Federal excess profits taxes for the year 1917, and turns on whether a deductible loss is allowable for that year, because of the worthlessness of certain stock. The respondent, Aluminum Goods Manufacturing Company, purchased in 1914 all the capital stock of the

Aluminum Sales Company. In 1917, the Sales Company was liquidated. Its assets were less than its obligations, so that its stock thereupon became worthless in the hands of the respondent. The cost of the stock of the Sales Company was charged off the respondent's books as a loss by the close of 1917 (R. 11). No business of any kind was transacted by the Sales Company after 1917, and it was dissolved in February, 1918 (R. 13, 14). Under the tax laws applicable to 1917, corporation income taxes are to be calculated on the basis of separate returns, even though two corporations were so related as to satisfy the definition of "affiliation." But for excess profits tax purposes, two companies are to have their excess profits tax calculated on the basis of a consolidated return, if their relationship was within that definition. The respondent claimed the right to deduct the loss from its 1917 gross income both for income tax purposes (involving a separate return) and for excess profits tax purposes (involving a consolidated return). The Commissioner allowed it as a deduction for income tax purposes, but denied it as a deduction for excess profits tax purposes (R. 12). The Board of Tax Appeals sustained the Commissioner (R. 21); the Circuit Court of Appeals reversed the Board of Tax Appeals (R. 29); the propriety of that reversal is now before this Court.

Summary of Argument.

The Revenue Acts of 1916 and 1917 allow as deductions in computing net income losses actually sustained and charged off within the year, and Government regulations have consistently recognized that if property becomes worthless, the taxpayer does not have to sell it to get the deduction; in this case the stock became worthless in 1917, so that the deduction is within the terms of the statute and regulations.

If this worthless stock had been sold to an outsider for a nominal sum, no question could have been raised as to

the deductibility of the loss. There is no practical reason for a different result when stock becomes hopelessly worthless, but is not sold. The sale would be a useless gesture. It is unreasonable to suppose that Congress, having provided for losses generally, could have intended that taxpayers whose losses were suffered in this particular manner should fail to get any deduction benefit therefrom. The respondent having started a stock transaction in 1914 and closed it in 1917 by abandonment of the worthless stock, (when it charged it off) suffered a loss of precisely the type which Congress intended to be deducted.

A determination of worthlessness involves only one party—the owner—and hence cannot be an "intercompany" transaction. Even though worthlessness is *demonstrated* by some transaction, the worthlessness is an independent basis for the deduction.

Intercompany transactions are not referred to in the tax law. The Commissioner is without authority to establish a rule that all intercompany transactions are to be disregarded in a consolidated return. Regulations 41, governing the imposition of this tax, do not establish any such rule. Nor has the Commissioner power to invoke such a theory in order to make a distinction between the case where a worthless asset is sold for a nominal price and the case (in practical effect the same) where abandonment occurs without such sale.

Even if there were a rule that all intercompany transactions are to be disregarded, the rule would not apply in this case. Affiliation was broken when the subsidiary abandoned active business and liquidated.

There is no merit in the contention that a separate return is to be filed for a fractional part of a day following the liquidation of the subsidiary. Settled Government regulations are to the effect that no separate return is required for such small fractions of the taxable year. It is funda-

mental that the income of a taxpayer even though affiliated during the year with another taxpayer, is to be computed upon an annual basis. It is not reasonable to assume that Congress intended that a taxpayer which had suffered a real loss, should be deprived of the benefit of it by assigning it to a small separate period in which there could be no income to offset it.

Argument.

I.

The Loss Claimed by the Respondent Meets Every Statutory Requirement as a Deduction.

It is provided in Section 12(a) Second, Revenue Act of 1916, amended, that in computing net income there shall be deducted from gross income:

> "All losses actually sustained and charged off within the year * * *."

No one disputes that the Sales Company completely liquidated its assets within 1917 and that they were not sufficient to meet its obligations. Thereupon the stock of the Sales Company became worthless and the cost thereof was the measure of the loss to the respondent. The Commissioner's allowance of the loss for income tax purposes so adjudicates.

The question whether a taxpayer could have a loss in respect of an asset which had become absolutely worthless (without selling it) was early presented in the Bureau, and continuously for more than fifteen years the regulations have provided that sale was not necessary. See Article 178, Regulations 33; Article 173, Regulations 74. This kind of deductible loss was called in the Regulations "loss of useful value." These regulations recognized the fact that if worthless property—whether corporate stock or ma-

chinery or other assets—was sold to an outsider for a nominal sum, no question could possibly be raised as to the deductibility of the loss, and that the same practical result occurs when such property becomes hopelessly worthless and useless. To require sale in order to get the deduction would be to require a useless procedure.

The respondent started a venture in 1914 by purchasing the corporate stock of the subsidiary from third persons, and closed that venture in 1917, no part of the original cost being recovered. This is a loss of precisely the type which Congress intended to be deducted. It is unreasonable to suppose that Congress, having provided for losses generally, could have intended that a taxpayer situated as this one is should fail to get any deduction for his loss. It is clear that if no deduction is allowed for this loss in 1917, the taxpayer will never have a chance to take it as a deduction.

Where one corporation makes an investment by purchasing all the stock of another and after a number of years abandons the investment as a total loss, that loss is clearly deductible, under the specific language of the tax law, no matter what the *cause* of the diminution in value between purchase and disposition. The diminution in value of a stock so purchased for an investment might be due to an unrealized decline in value of its capital assets over a period during which it was held, or to the fact that it operated without being able to make a profit, or that its operations had shown an actual loss, or to other causes. The tax law does not operate differently as regards varying causes of the diminution in value of the stock. In those relatively rare cases where the diminution in value of the stock is due only to the fact that the corporation lost money, the deduction of the whole loss realized by the stockholder on disposition is nevertheless allowable. In other words, it does not matter whether the lessening in value of the stock was due to losses which had been realized by the corpora-

tion or to losses (such as diminution in the value of land) which involved unrealized shrinkage of value.

Petitioner's brief, page 21, appears erroneously to assume that a corporation which buys all the stock of another corporation and disposes of it at a loss in 1917 cannot use that loss as a deduction in 1917 if the subsidiary has claimed losses in the years 1914 to 1917, inclusive. Thus the petitioner's brief says (p. 21):

> "The losses actually incurred by the Sales Company in its operations during 1917 were allowed as deductions by the petitioner. This loss and losses of prior years were reflected in the depreciation of its stock and the exhaustion of its assets which rendered its debts uncollectible."

This argument is unsound because (1) it erroneously assumes that a corporation claiming a loss on 100 per cent-owned stock must diminish that loss by any losses the subsidiary has claimed while it was owned by that taxpayer (an assumption wholly without foundation; *United Publishers' Corporation v. Anderson*, 42 Fed. (2d) 781) and (2) it also assumes that the diminutions in value of the Sales Company stock between 1914 and 1917 are necessarily due to realized losses. If there were any such principle as that suggested in the petitioner's brief, then it is clear that the Commissioner would not have allowed this loss for income-tax purposes.

II.

The Doctrine of Intercompany Transactions is Immaterial Here Because Only One Party is Involved in a Determination of Worthlessness.

The Commissioner's reason for refusing to recognize the loss as deductible in computing consolidated net income for excess profits tax purposes (in spite of the fact that he held

it deductible in computing net income for the purpose of the corporation income tax) was that the liquidation "was an intercompany transaction."

This overlooks the fact that where a separate taxpayer or a taxpayer in a consolidated group determines that an asset is worthless (whether that asset is a machine or a corporate stock) during the taxable year, and charges it off, the loss deduction is allowable. Such a determination that a machine or a stock is worthless is not a transaction between two parties, but merely an act of the owner. The determination of worthlessness cannot be an intercompany transaction, since it is an act of only one party. Even though the Commissioner disregards the liquidation transaction, which *disclosed* worthlessness, there still remains the determination of worthlessness by the owner of the asset, and the owner is entitled to the deduction under the previously mentioned regulations regarding "loss of useful value."

III.

There is no Requirement in the Law That Every Intercompany Transaction is to be Disregarded.

Considering further the reason which the Commissioner gave for refusing to allow this loss—that the loss resulted from an intercompany transaction—it is here contended, first, that the Commissioner is without authority to establish a rule that all intercompany transactions, without exception, are to be disregarded in a consolidated return; and, second (see part IV of this brief), that even if it is assumed that the Commissioner has power to establish so broad a rule, this case does not come within it because, here, affiliation was terminated before the loss was realized.

It is significant that the term "intercompany transaction" does not appear anywhere in the statute. The Com-

missioner's reason for disallowing the deduction is not based on anything in the statute. Respondent does not dispute the propriety of eliminating certain types of transactions between affiliated companies in calculating consolidated net income. Some such elimination is undoubtedly proper in certain cases where such transactions would result in a deduction not intended by Congress. But whatever may be the notion of the administrative department or of the accounting profession as to the correct *definition* of eliminable intercompany transactions, such definition may be applied in determining consolidated net income only so far as it does not conflict with the purpose of the law as plainly expressed in its specific provisions. There is no reason to assume that Congress has given the Commissioner the power to disregard all intercompany transactions. If Congress had intended so simple and general a rule, undoubtedly such a provision would have appeared in the law.

Thus Regulations 41 relative to the war excess profits tax under the Revenue Act of 1917, Art. 77, provided merely that every corporation shall describe all intercorporate relationships with a view of "equitable and lawful accounting." Even these regulations do not provide that intercompany transactions shall be eliminated; in fact the term "intercompany transactions" does not appear even in the regulations having to do with the Revenue Act of 1917.

The Commissioner was plainly not warranted in invoking a mere theory that all intercompany transactions were to be disregarded in a case such as this where the effect of the application of that theory is to arrive at a curious distinction between the case of sale of a worthless asset, and its abandonment—a distinction which has generally been held unfounded. Neither the parent corporation nor the affiliated group would have been any better off if there had been the formality of a sale of the stock to an outside interest for a nominal consideration. The Commissioner is with-

out authority to create and apply a theory which makes an entirely illogical difference in the result between sale of worthless stock and mere abandonment of it.

Congress could not have intended to deprive holding companies of the loss sustained in a venture merely because the company liquidated the stock and found it worthless, instead of selling it to a third person for a nominal sum.

Petitioner's brief undertakes, at some length, to set forth the purpose of the requirement regarding consolidated returns for 1917. We submit that petitioner's assumptions in this regard are erroneous. The purpose may be stated plainly and briefly. It is to insure the imposition of the excess profits tax upon the basis of the true net income and true statutory invested capital of units of two or more corporations owned or controlled by the same interests and engaged in the same or closely related businesses. Thus, such corporations are prevented from circumventing the statutory provisions relating to separate corporations, by arbitrarily shifting items of income or deductions from one to the other through the medium of inter-corporate manipulation.

The primary purpose of the provisions for consolidated returns is not, as brief for the petitioner submits (p. 13), "to reflect accurately the true financial condition of a business enterprise by disregarding the corporate units which compose the whole." There is no authority for that statement. The taxing statute does not concern itself with "the true financial condition of a business enterprise," except as it may facilitate the determination of statutory net income and statutory invested capital. To argue otherwise merely confuses the issue.

On page 22 of petitioner's brief, he argues—

> "If, as the Circuit Court of Appeals holds, the losses in question may be deducted upon the consolidated return of the respondent and the Sales Company, it results that the excess-profits tax is to be computed upon

> the basis of the *separate* net income of the respondent but at rates determined by the use of the *consolidated* invested capital of both corporations. Such a result finds no sanction in law and contravenes the requirement of the statute that the excess-profits tax be determined on the basis of consolidated net income *and* invested capital. * * *"

We believe petitioner is in error in so stating. The result there mentioned is definitely sanctioned by the law and was actually reached in many cases. For instance, where one member of an affiliated and consolidated group has no net income and its affiliates have net income, the consolidated net income is taxed at a less excess profits tax rate because the invested capital of the group includes the invested capital of the no-income affiliate. In every case where one member of an affiliated and consolidated group has a net loss and its affiliates have net income, the consolidated net income is arrived at by offsetting the net loss against the sum of the other net incomes, and the consolidated invested capital is the sum of the separate invested capital of all the affiliated corporations. The result in such case is a definite diminution of the rate of excess profits tax as compared with the rate in case of separate returns. Petitioner is in error in assuming that there is anything unusual or inconsistent with the general plan of the law in the result arrived at by the Circuit Court of Appeals.

IV.

The Loss Occurred Outside the Period of Affiliation.

Even though the Commissioner had power to establish an absolute rule that all intercompany transactions of whatever kind are to be disregarded if they occur during the period of affiliation, the rule would not apply in this case. Affiliation was broken when the subsidiary abandoned active business and liquidated.

The definition of affiliation applicable to the year 1917 is much narrower than the statutory definition which applied to 1918 and subsequent years.

The Revenue Act of 1921, Section 1331, provided that, under the Revenue Act of 1917, a corporation was to be deemed affiliated with one or more other corporations "when such corporation * * * owned directly * * * all or substantially all the stock of the other or others * * *, *Provided,* that such corporations * * * were engaged in the same or a closely related business, * * *."

The petitioner in his brief failed to bring out that for the year 1917 more than mere stock ownership is required for affiliation. Later statutes with different provisions are not pertinent.

The provision above quoted plainly prescribes two requisites for affiliation, viz,—

(1) ownership of substantially all the stock and,
(2) engagement in the same or a closely related business.

One of these attributes is not sufficient.

No one disputes that the Sales Company discontinued its business in 1917 before liquidation and within that year completely liquidated its assets. It was not "engaged in the same or a closely related business" after it abandoned all business. When the subsidiary corporation ceased business within the year 1917 its engagement in "the same or a closely related business" as that of the respondent, at that moment it ceased to be affiliated with the respondent.

It is true that for a period the Commissioner had a practice (we contend an erroneous one) of holding that purchase from and sale to outside interests of the stock of a company, which after the purchase was affiliated, were both inter-company transactions. The Board of Tax Appeals agreed with that practice until the Circuit Court of Ap-

peals, for the Second Circuit, in *Remington Rand, Inc. v. Commissioner,* 33 Fed. (2d) 77 (cert. denied 280 U. S. 591), reversed that holding, saying at page 78:

> "Both the purchase and the sale took place outside the period of affiliation, and were made by the seller for its own account, not for the account of the affiliated group * * *."

The Tax Board now holds that a parent company realizes gain or loss upon the liquidation of a subsidiary.

Riggs National Bank v. Commissioner, 17 B. T. A. 615, affirmed (C. C. A.-4), 57 Fed. (2d) 980.
Canal-Commercial National Bank v. Commissioner, 22 B. T. A. 541.
Houghton & Dutton Company v. Commissioner, 26 B. T. A. ———.
Prosperity Company, Inc. v. Commissioner, 27 B. T. A. ———.

A similar conclusion was reached in *American Printing Company v. United States* (District of Massachusetts), 53 Fed. (2d) 98; and *Wilmington Steamboat Company v. Sturgess* (District of N. J.), 52 Fed. (2d) 210, affirmed 55 Fed. (2d) 831. The Tax Board and the courts have reached this conclusion under the theory that distributions in liquidation are equivalent to payments in exchange for stock. (*Hellmich v. Hellman,* 276 U. S. 233.)

The stockholder, having received all the assets, is no longer the beneficial owner of the stock it is exchanging for the assets, no matter who has possession of it. The liquidating corporation, after it has delivered its assets for its stock, is the real owner of its stock.

The only reason given by the United States Board of Tax Appeals for denying the loss claimed in the instant case was that "the petitioner continued to own all the Sales Company stock and filed a consolidated return * * *."

We submit that this reason is not sufficient. The distribution in liquidation and not the dissolution of the Sales Company determined the worthlessness of the stock. After distribution of assets there was a mere shell. It would be unreasonable to assume that Congress intended the deduction to depend on an unimportant circumstance—namely, whether dissolution was prompt or slow.

V.

No Separate Return is Required for the Small Fraction of a Year Following Liquidation.

On page 23 of petitioner's brief he argues that even if it is held that the loss was sustained outside the period of affiliation, it would be deductible only in computing the separate net income of the respondent in a return filed for the short period—apparently less than a day—between the time of liquidation of the subsidiary and the end of the year 1917. This would produce an entirely unreasonable result, and is contrary to the law and the regulations.

The tax is imposed upon the net income for the taxable year, determined in the manner prescribed by the statute. The taxable year is the calendar year, except in the case of a corporation allowed to fix its own fiscal year. The first taxable year is the year ended December 31, 1917 (Section 200 of the Revenue Act of 1917).

The Treasury Department's Regulations 41, Articles 77, 78, providing for 1917 consolidated returns, contemplated that the separate incomes and separate invested capital of the several affiliated taxpayers would be combined so that the affiliated group would represent merely a tax-computing unit and not a new taxpayer. Individual corporations in an affiliated group do not lose their status as taxpayers. (*Woolford Realty Company, Inc. v. Rose,* 286 U. S. 319).

The statute required the respondent and the Sales Company to make separate returns of their separate net in-

comes for the taxable period. The taxable period of respondent and the Sales Company was the calendar year 1917.

The excess profits tax for 1917 is imposed upon the consolidated net income of these corporations for the calendar year 1917. There is no authority in the statute nor any attempt in the Treasury Regulations to levy the tax upon any other basis or for any other period.

The argument in the petitioner's brief would brush aside and nullify the most fundamental principle underlying income taxation, namely, the periodic determination of income. The statute adopts the period of one year as the period for which every taxpayer's net income and tax thereon shall be determined.

The notion that the tax may be computed upon the basis of separate returns by the same taxpayer for separate portions of the same taxable year not only has no sanction in law but would conflict with the purpose of the statute. In the case of income taxes, little or no difference may result from the computation of the tax upon the basis of separate returns of net income for separate portions of the taxable period. Income taxes are fixed percentages of net income less certain credits and exemptions. This is not true of excess profits taxes, which are based upon net income but measured by varying rates according as the net income may exceed certain percentages of invested capital. To attempt to compute the tax on the basis of net income and invested capital (consolidated or of a separate corporation), determined separately for separate portions of the same taxable year, would not only produce illogical results, but would involve arithmetical problems of great complexity.

This question was before the United States Board of Tax Appeals in the *Houghton & Dutton Company v. Commissioner, supra.* In concluding that the loss sustained should be deducted from the income for the entire year, the Board gave these reasons, which appear to be sound:

"* * * Deeply rooted in the Federal tax system is the fundamental idea of computation of taxes on an annual basis. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359; *Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301. Even though affiliated with others, each corporation is still a taxpayer, (*Woolford Realty Co., Inc. v. Rose*, 286 U. S. 319), and as such is entitled to have its taxes computed on the basis of its taxable year, which requires that it report all income received within the year as yearly, and not daily, income, and carries with it the correlative right to all the statutory deductions growing out of transactions within the year without regard to the particular day on which they occurred.

"It is argued by respondent that his position here is in accordance with Article 634, Regulations 45, as amended by T. D. 4022 (C. B. VI-1, p. 258) which provides that where two corporations are affiliated at the beginning of the year, but, due to a change in stock ownership or control during the year, affiliation is terminated, a consolidated return shall be filed for the period of affiliation, and a separate return should be filed for each for the remainder of the year. The respondent's theory, if carried into practice, would require the filing of a separate return in cases like this for the fractional part of a day between the close of business on the last day and the end of the year.

"The same provisions appear in subsequent regulations (Art. 634, Reg. 62 and 65), but these later regulations provide further that:

> 'in any case in which the consolidated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed.'

"The respondent's position as asserted here is contrary to the quoted provision which has now been long established.

"We are unable to perceive the necessity of a separate return by the parent company for the period within the year following the termination of affiliation."

The sensible and long-followed administrative custom of disregarding short fractions of a year, embodied in the

regulations cited by the Tax Board, should be decisive if the question were doubtful. But the illogical and unfair results of the fractional year theory—depriving the taxpayer of any real benefit of the deduction—indicate strongly that Congress could never have intended it.

Respectfully submitted,

WARD LOVELESS,
Amicus Curiae.

Washington, D. C.,
December, 1932.

SUPREME COURT OF THE UNITED STATES.

No. 192.—October Term, 1932.

David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Aluminum Goods Manufacturing Company. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[January 9, 1933.]

Mr. Justice Stone delivered the opinion of the Court.

In 1914 respondent, a New Jersey manufacturing corporation, purchased all the capital stock of the Aluminum Sales and Manufacturing Company, a New York corporation. From that time until its liquidation, carried on in 1917, the Sales Company was principally engaged in selling goods manufactured by respondent. In February, 1918, it was dissolved. The operation of the Sales Company reflected net losses during the years 1914, 1915 and 1916, as well as in the year 1917. As a result of the operating losses and the liquidation of the Sales Company, respondent suffered the loss of certain sums advanced to the Sales Company, and of the total investment in its stock.

For 1917 the two corporations filed separate returns for computation of the normal income tax, and a consolidated return for the purposes of the excess profits tax. In its separate return respondent claimed, and the Commissioner allowed, deduction of an aggregate loss made up of respondent's advances to the Sales Company, and the cost of its stock, less the value of equipment and good will realized on its liquidation. This loss, reduced by the 1917 operating loss of the Sales Company, was deducted from gross income in the consolidated return. The Commissioner's refusal to allow the deduction was sustained by the Board of Tax Appeals, 22 B. T. A. 1, whose determination was reversed by the Court of Appeals for the Seventh Circuit, 56 F. (2d) 568. The Court of Appeals held that respondent's affiliation with the Sales Company was ended by the liquidation in 1917, so that

the loss was suffered "outside the period of affiliation," and that, in any case, as the loss did not result from an "intercompany" transaction, it could be deducted in the consolidated return. This Court granted certiorari, — U. S. —, to resolve an alleged conflict with the decision of the Court of Claims in *Utica Knitting Co.* v. *United States*, 68 Ct. Cls. 77, and see *Autosales Corporation* v. *Commissioner*, 43 F. (2d) 931, 933.

Title II of the Revenue Act of 1917, 40 Stat. 300, 302, imposed a war excess profits tax in addition to the normal tax upon the income of corporations. The statute made no provision for consolidated returns by affiliated corporations, but Articles 77 and 78 of Treasury Regulations 41, adopted pursuant to the Act, did authorize the Commissioner to require affiliated corporations, including those, the stock of one of which was owned by another, to file a consolidated return of net income and invested capital. And § 1331 of the Revenue Act of 1921, 42 Stat. 227, 319, provided that for the purpose of determining excess profits taxes the Revenue Act of 1917 "shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917".[1]

The purpose of requiring consolidated returns by affiliated corporations was, as the Government contends, to impose the war profits tax, according to true net income and invested capital of what was, in practical effect, a single business enterprise, even though conducted by means of more than one corporation. Primarily, the consolidated return was to preclude reduction of the total tax payable by the business, viewed as a unit, by redistribution of income or capital among the component corporations by means of intercompany transactions. See *Handy & Harman* v. *Burnet*, 284 U. S. 136, 140; *Appeal of Gould Coupler Co.*, 5 B.

[1]Subsequent to 1917, affiliated corporations were required to file such a return for all purposes for any taxable year prior to January 1, 1922 (§ 240, Revenue Act of 1918, 40 Stat. 1057, 1081; § 240, Revenue Act of 1921, 42 Stat. 227, 260). Thereafter, it became optional whether to file a consolidated or separate returns. (§ 240, Revenue Act of 1921; § 240 Revenue Act of 1924, 43 Stat. 253, 288; § 240 Revenue Act of 1926, 44 Stat. 9, 46; §§ 141, 142, Revenue Act of 1928, 45 Stat. 791, 831, 832.)

T. A. 499, 514-516; *cf.* Treasury Regulations 41, Art. 77; Treasury Regulations 45, Art. 631.

It is not denied that the two corporations became affiliated when respondent acquired all the capital stock of the Sales Company. But on the basis of the finding of the Board of Tax Appeals that the Sales Company was chiefly engaged during 1917 in closing up its business preparatory to formal dissolution, which took place in February, 1918, that all its assets and liabilities were disposed of by the end of 1917, and that it did not do any business after that date, petitioner argues that the affiliation of the two companies was terminated by the liquidation.

Since complete stock ownership is made the test of affiliation applicable here under Article 77 of Treasury Regulations 41 and § 1331 of the Revenue Act of 1921, no ground is apparent for saying that the corporations ceased to be affiliated, merely because, without change of corporate control, one of them was being liquidated. The findings do not reveal that the liquidation of the Sales Company was completed, that it ceased to do any business or to function as a corporation before the end of 1917. Neither statute nor regulations recognize that affiliation may be terminated by the mere fact that such liquidation is being carried on, and the reasons for requiring the consolidated return may be quite as valid during that liquidation as before. During that period the unitary character of the business enterprise is not necessarily ended and intercompany manipulations are not precluded.

In the present case, even though the affiliation continued, it does not follow as a matter of law that the loss was not rightly deducted in the consolidated return. Section 12, Revenue Act of 1916, 39 Stat. 756, 767, governs the computation of the excess profits tax under § 206, Revenue Act of 1917, 40 Stat. 300, 305. That section and the regulation under it (see Article 147, Treasury Regulations 33 [1918 ed.]) direct that taxable net income of a corporate taxpayer shall be ascertained by deducting, from gross income, losses sustained within the year. It is conceded that the loss of respondent's advances to the Sales Company and the investment in its stock was sustained in 1917, was deductible therefore, if at all, in that year, and might properly have been deducted by respondent in a separate return, if a separate return had been permissible. But the Government insists that the loss cannot be deducted in the mandatory con-

solidated return for 1917 because it occurred as the result of "intercompany" transactions.

We need not decide whether the loss resulted from intercompany transactions within the meaning of the regulations under later statutes[2] which broadly exclude from the consolidated returns profit or loss upon all such transactions. For neither the Revenue Act of 1917, nor § 1331 of the Revenue Act of 1921, nor the regulations under them[3] prescribe specifically the method of making up the consolidated return or require the elimination from the computation of the tax of the results of all intercompany transactions. Article 77 of Treasury Regulations 41 required every corporation to describe in its return "all its intercorporate relationships with other corporations, with which it is affiliated", and to "furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting". Article 78 authorizes the Commissioner to require consolidated returns of affiliated corporations "wherever necessary to more equitably determine invested capital or taxable income", and provides that "the total tax will be computed in the first instance as a unit on the basis of the consolidated return".

These provisions plainly do not lay down any rigid rule of accounting to be applied to consolidated returns which would exclude from the computation of taxable income the results of every intercompany transaction, regardless of its effect upon the capital or the net gains or losses of the business of the affiliated corporations. Instead, they merely disclose the purpose underlying regulations and statute to prevent, through the exercise of a common power of control, any intercompany manipulation which would distort invested capital or the true income of the unitary business carried on by the affiliated corporations. Hence, no method of ac-

[2]See art. 637, 864 of Treasury Regulations 45 under the Revenue Act of 1918; art. 635, 864 of Treasury Regulations 62 under the Revenue Act of 1921; art. 636 of Treasury Regulations 65 under the Revenue Act of 1924; art. 635 of Treasury Regulations 69 under the Revenue Act of 1926; art. 734 of Treasury Regulations 74 and art. 15, 31, 37 (a), 38 (b) of Treasury Regulations 75 under the Revenue Act of 1928.

[3]Article 1735 of Treasury Regulations 62, under § 1331 of the Revenue Act of 1921, merely refers to Treasury Regulations 41 under the Revenue Act of 1917.

counting, in calculating taxable income upon the consolidated return, can be upheld, which would withhold from the taxpayer all benefit of deduction for losses actually sustained and deductible under the sections governing the computation of taxable income, and which at the same time would not further, in some way, the very purpose for which consolidated returns are required.

Such, we think, is the effect of the method adopted by the Commissioner. The Sales Company suffered losses during the years 1914, 1915 and 1916 which could not be deducted in its separate returns for those years, because they were net losses, and which could not be deducted from the profits of the parent company because there was no consolidated return in those years. While it may be assumed that those losses affected the value of the stock owned by the parent company, the loss of its investment in the stock of the Sales Company and in advances to it could not be deducted by the parent company in its separate return for those years because the loss had not then been sustained with such finality as to permit its deduction under the applicable statute and regulations. So far as the loss from operation of the Sales Company in earlier years contributed to respondent's capital loss in 1917, deduction of the latter in the consolidated return involved no double deduction of losses of the business of the two companies during the period of their affiliation. As respondent's total loss in 1917 was reduced, before deduction in the consolidated return, by the amount of the operating loss of the Sales Company for that year, there was no duplication of any losses accrued or sustained in that year.

The loss was a real one, suffered by respondent as a separate corporate entity and it was equally a loss suffered by the single business carried on by the two corporations during the period of their affiliation, ultimately reflected in the 1917 loss of capital invested in that business. While equitable principles of accounting applied to the calculation of the net income of the business unit do not permit deduction of the loss twice, they do require its deduction once. Hence, the loss was deductible in 1917 under the statute and regulations controlling computation of taxable income, and its deduction is not forbidden by the regulations applicable to the consolidated return. Articles 77 and 78 of Treasury Regulations 41 would, indeed, require the elimination of any losses resulting

from intercompany transactions the inclusion of which would defeat the purpose of consolidated returns to tax the true income of the single business of affiliated corporations, calculated by correct accounting methods. The deductions claimed here had no such effect.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.